

APPENDIX

FILED

FEB 21 1974

MICHAEL RODAK, JR., CLERK

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-718

**BANGOR PUNTA OPERATIONS, INC. and BANGOR
PUNTA CORPORATION,**

Petitioners,

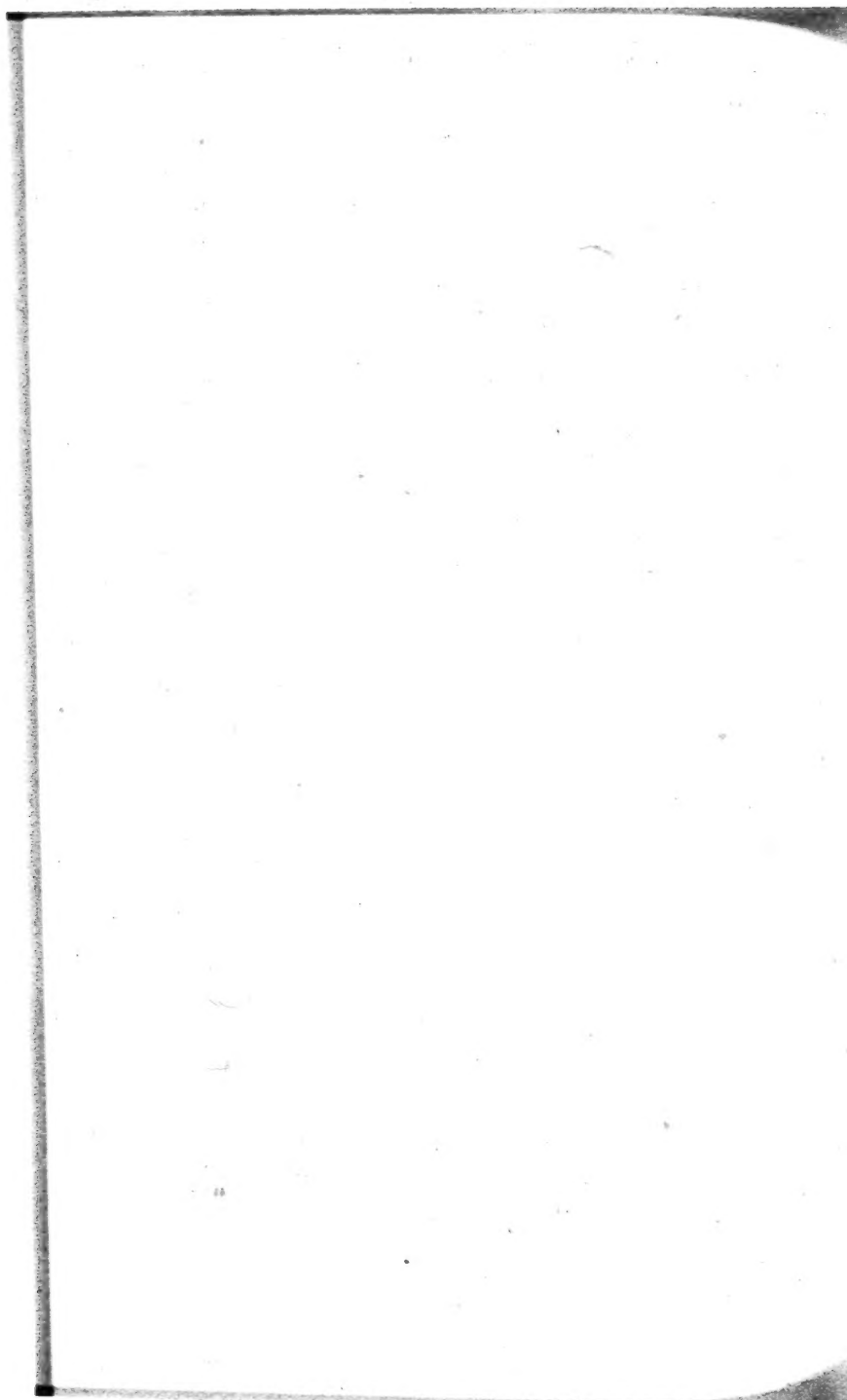
v.

**BANGOR & AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,**

Respondents.

**ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIRST CIRCUIT**

**Petition for Certiorari filed October 31, 1973
Certiorari granted January 7, 1974**



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District Court Docket Entries

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<i>Date</i>	<i>Proceedings</i>
1971	
Dec. 30	Complaint, filed.
1972	
Jan. 3	Summons issued and given to U. S. Marshal for service.
Jan. 6	Return on Summons served on Robert Williamson for C. T. Corp. agent to accept service for Bangor Punta Operations, Inc. executed by U. S. Marshal, filed.
Jan. 6	Return on Summons served on Robert Williamson of C. T. Corp. agent to accept service for Bangor Punta Corporation, executed by U. S. Marshal, filed.
Jan. 18	Defendants' Motion to Dismiss and to Strike, with affidavit, filed.
Jan. 18	Appearance of Sumner T. Bernstein for defendants, filed.
Jan. 18	Appearance of Herbert H. Sawyer for defendants, filed.
Jan. 27	Letter received from counsel for defendant, seen and agreed to by counsel for plaintiff, agreeing that all further proceedings in this case be had at Portland.
Aug. 17	Hearing on defendants' Motion to Dismiss.
Aug. 17	Preliminary Pretrial Conference had.
Aug. 18	Report of Preliminary Pretrial Conference and Order, filed. Copies to counsel.

District Court Docket Entries.

<i>Date</i>	<i>Proceedings</i>
Aug. 18	Order upon Defendants' Motion to Dismiss and to Strike, Gignoux, J., filed. Copies to counsel.
Aug. 18	Amended Complaint of plaintiffs, filed.
Sept. 14	Defendants' Answer to Amended Complaint, filed.
Sept. 14	Defendants' Motion for Summary Judgment, with Memorandum of Law in support thereof, filed.
Nov. 6	Oral argument heard on defendants' Motion for Summary Judgment; taken under advisement by the Court.
Nov. 6	Further Pretrial Conference had.
Nov. 7	Report of Further Pretrial Conference and Order filed; copies mailed to counsel.
Nov. 28	Transcript of proceedings at oral arguments upon defendants' Motion for Summary Judgment, filed.
Dec. 29	Opinion and Order of the Court, Granting defendants' motion for summary judgment dismissing the entire complaint, signed E. T. Gignoux, J. filed.
Dec. 29	Attested copy of Opinion and Order of the Court sent to attorneys of record.
1973	
Jan. 26	Notice of Appeal by plaintiffs to U. S. Court of Appeals for First Circuit from Order of District Court granting defendants' Motion for Summary Judgment dismissing the Complaint entered in this action on the 29th day of December 1972, filed.

District Court Docket Entries

<i>Date</i>	<i>Proceedings</i>
Feb. 5	Motion re: documents to be included in record on appeal filed by plaintiffs.
Feb. 9	Endorsement granting leave to include certain affidavits in record on appeal.
Feb. 9	Affidavits of Frederic Dumaine and William Houston, filed.
Feb. 15	Motion by plaintiffs to include in record on appeal the Company report to the commission, as attached to plaintiffs' pretrial memorandum, filed.
Feb. 23	Original papers on appeal mailed to U. S. Court of Appeals for First Circuit.
Feb. 27	Reply of Defendants to Plaintiffs' Supplemental Motion re: Record on Appeal dated February 14, 1973, Filed.
Feb. 28	\$250 Surety Bond on Appeal, Filed.
Mar. 2	Hearing had on motion by Plaintiffs to include in record on appeal the ICC report. Motion denied by Judge Gignoux.
Mar. 21	The transcript of hearing on Plaintiffs' motion to include report was filed.
Mar. 27	Memorandum and Order of Court of Appeals denying without prejudice appellants' motion to supplement record on appeal, filed.
Aug. 6	Opinion of U. S. Court of Appeals, filed. Reversed and remanded for proceedings consistent herewith.
Aug. 22	Order from Court of Appeals denying motion for stay of mandate, filed.

District Court Docket Entries

<i>Date</i>	<i>Proceedings</i>
Aug. 31	Mandate of Court of Appeals vacating order of District Court and remanding proceedings for further action consistent with opinion, filed.
Oct. 15	Defendants' request for production of documents, filed.
Nov. 8	Stipulation extending time for Plaintiff to respond to Defendants' request for production of documents, filed. Approved November 13, Morris Cox, Magistrate.
Dec. 19	Plaintiffs' response to Defendants' notice for production and inspection of documents, filed.
Dec. 19	Plaintiffs' general request for production of documents from defendants, filed.
Dec. 19	Plaintiffs' interrogatories to Defendants re: 4th and 5th affirmative defenses, filed.

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Jan. 25	Stipulation that time for Defendants to respond to Plaintiffs' request be, and hereby is extended, filed. [February 5—"So Ordered," Gignoux, J.]
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Court of Appeals Docket Entries

<i>Date</i>	<i>Proceedings</i>
1973	
Feb. 27	Record was filed and case docketed.
Mar. 7	Appearances of counsel, filed.
Mar. 9	Further appearances, filed. Statement and appellants' designation, filed.
Mar. 12	Appellants' motion re: supplemental record, filed.
Mar. 19	Brief of appellees in opposition to motion re: supplemental record, filed.
Mar. 21	Counterdesignation of appellees, filed.
Mar. 21	Appendix to appellees' brief in opposition to appellants' motion for a supplemental record, filed.
Mar. 23	Transcript of District Court proceedings, received and filed.
Mar. 26	Memorandum and Order denying without prejudice appellants' motion re: supplemental record.
April 3	Brief for appellants and Appendix to that brief, filed.
April 24	Brief for appellees, filed.
April 30	Order assigning case for hearing at May, 1973 session.
May 7	Case was heard before Coffin, C. J., McEntee, J., Campbell, J.
Aug. 3	Judgment entered—Order of District Court is Vacated and the cause is remanded to that court for further proceedings consistent with the opinion filed today. No costs at this time. Opinion by Campbell, J.

*Court of Appeals Docket Entries**Date**Proceedings*

- Aug. 17 Motion for stay of mandate, filed.
- Aug. 21 Opposition to motion for stay of mandate, filed.
- Aug. 23 Order denying motion for stay of mandate without prejudice to the District Court's control of discovery of process.
- Aug. 30 Mandate issued and original papers returned to District Court.
- Nov. 2 Received notice of filing Petition for Certiorari (filed October 31, 1973).
- 1974
- Jan. 15 Received certified copy of order granting certiorari (dated January 7, 1974).

UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

NORTHERN DIVISION

BANGOR AND AROOSTOOK RAILROAD
COMPANY AND BANGOR INVESTMENT
COMPANY,

*Plaintiffs,**v.*

BANGOR PUNTA OPERATIONS, INC., AND
BANGOR PUNTA CORPORATION,
Defendants.

Civil Action
No. 1933

AMENDED COMPLAINT

The Plaintiffs, The Bangor and Aroostook Railroad Company and Bangor Investment Company respectfully allege as follows:

1. This civil action arises between citizens of different states, the amount in controversy, in each count, exclusive of costs and interest, exceeding Ten Thousand Dollars (\$10,000.00). In addition, Counts IV and XII herein arise under Section 10 of the Clayton Act (Title 15, U.S.C. Section 20). Counts VI, VIII, X and XIII arise under Section 10(b) and 27 of the Securities Exchange Act of 1934, as amended (Title 15, U.S.C. Sections 78j(b) and 78aa) and Rule 10b-5 (CFR Sec. 240.10b-5) as promulgated thereunder by the Securities and Exchange Commission. Accordingly, this Court has jurisdiction under Title 28 U.S.C. Section 1332(a)(1) and Section 1337 and Title 15 U.S.C. Section 77(v).

2. Plaintiff, the Bangor and Aroostook Railroad Company (hereafter, BAR) is a Maine corporation organized in

Amended Complaint

1891 for the purpose of constructing, maintaining and operating a railroad for public use, and has its principal place of business in Bangor, Maine. It operates a railroad providing essential services for those persons and businesses located in the northern part of the State of Maine. BAR connects within the State of Maine with other railroads which serve the northeastern part of the United States and which, in turn, connect with other railroads serving the remainder of the United States. Freight shipments of BAR consist of products grown and manufactured in the State of Maine, including potatoes, pulp and paper products, which are sold and used in other parts of the United States.

3. Plaintiff, Bangor Investment Company (hereafter, BIC) is a Maine corporation incorporated in 1904, having its principal place of business at Bangor, Maine. Its total authorized capital stock is 250,000 shares, of which 250,000 shares are outstanding and all of which are owned by Plaintiff BAR and have been so owned during all the period of time covered by this complaint. As will hereafter appear in this complaint, BAR has used BIC for various purposes. As the owner of all the outstanding stock of BIC, BAR has totally dominated and controlled BIC which in many instances acts as BAR's *alter ego*.

4. The defendant, Bangor Punta Corporation (hereafter, Punta) is a Delaware corporation having its principal place of business in Greenwich, Connecticut, and is qualified to transact business within the State of Maine. Its stock has been listed upon the New York Stock Exchange since 1964. Punta previously operated under the names of Punta Alegre Sugar Corporation and Bangor Punta Alegre Sugar Corporation.

5. The defendant, Bangor Punta Operations, Inc. (hereafter, Operations) is a New York corporation having its

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principal place of business in Greenwich, Connecticut, and is qualified to transact business within the State of Maine. Operations previously operated under the name of Punta Alegre Commodities Corporation.

6. Since its incorporation, Operations has been a wholly-owned subsidiary of Punta. During such period of time, businesses acquired by or in behalf of Punta have been held by and operated either as subsidiaries or divisions of Operations.

7. At a meeting held on March 1, 1960, the directors of BAR voted to undertake and complete a corporate reorganization in order to achieve diversification of BAR's business activities. Toward this end, the President of BAR introduced Nicholas M. Salgo of New York City (hereafter, Salgo) to the BAR board as a person able to effect a diversification program and willing to do so in return for options on BAR's stock. At said time and at all times thereafter relevant to this complaint, Salgo was an officer and director and substantial stockholder of Punta. He is presently Chairman of the Board of Punta.

8. On or about March 25, 1960, BAR and Salgo entered into a formal employment contract for a term of not less than ten years which provided that Salgo was "to suggest and develop an overall program for diversification of business activities of the Company (BAR), to explore specific avenues of diversification, to carry approved projects through to execution and to perform such other similar duties which may, from time to time, be required by the Board or by the President". At the same time, Salgo was granted a qualified option to purchase up to 20,000 shares of BAR's common stock as then constituted at \$26.50 per share. The number of shares which Salgo could acquire upon exercise of said option depended upon

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the future non-carrier earnings of BAR, on the basis of one share for each \$100.00 of net income before taxes.

9. On or about April 20, 1960, upon advice of Salgo, BAR formed Bangor & Aroostook Corporation (hereafter, B&A) under the laws of the State of Maine to become the holding company of BAR and other non-carrier corporations to be acquired. In addition, B&A assumed BAR's employment contract with Salgo and the obligations of the stock option granted to him by BAR. Of BAR's thirteen directors, seven became directors of B&A. The two corporations had the same chairman of the board, the same president, the same vice president-finance and general counsel, the same treasurer and the same comptroller. On or about November 29, 1960, at least 80% of BAR's stock had been tendered for B&A stock, and the acquisition was consummated. Between November 29, 1960 and September 21, 1964, B&A increased its ownership of BAR's issued and outstanding stock to over 98%.

10. On or about October 13, 1964, upon advice of Salgo, B&A sold all of its assets to Operations in exchange for capital stock of Punta. The agreement provided that Operations was to assume and pay, perform and discharge all of the debts, obligations, contracts and liabilities of B&A, whether or not reflected or reserved against in B&A's balance sheets, books of account and records. Of BAR's fifteen directors, eight became directors of Punta upon the sale of B&A's assets to Operations. These eight included the chairman, the vice chairman and the president of BAR. Effective October 2, 1969, Operations sold all its stock interest in BAR to Amoskeag Company, a Delaware corporation.

11. Throughout the period 1960 to 1969, first B&A and then its successor, Operations, the latter acting as the agent and instrumentality of Punta, dominated and controlled

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BAR and exploited it solely for their own purposes, to the injury of BAR and without regard to BAR's future obligations both to its creditors and to the public which it serves. By such domination, control and exploitation, B&A, Operations and Punta calculatedly drained the resources of BAR in violation of law for their own benefit, all as more specifically set out in the allegations below. Such domination and control resulted in fraudulent concealment of the systematic exploitation of BAR and, further, prevented any effective investigation being made of such exploitation and the commencement of any suit with respect thereto until after BAR was sold in 1969. The causes of action asserted in this Amended Complaint belong to BAR and are asserted directly by it. The injury to BAR is a continuing one surviving the aforesaid sale to Amoskeag.

12. Many of the acts complained of herein were never approved, authorized or ratified by BAR's directors and some acts may never have been known to them until after said sale to Amoskeag in October 1969. To the extent that some of BAR's directors did purport to approve, authorize or ratify such acts, a number of them acted under the domination and control of B&A, Operations, Punta and Salgo, without a full disclosure being made to them of all material facts. At no time, while B&A, Operations and Punta dominated and controlled BAR was there any ratification by BAR stockholders of any of the acts complained of herein, after a full, complete and candid disclosure of all material facts to them.

13. When Amoskeag acquired all of the common stock of BAR held by Operations, effective October 1, 1969, which amounted to 177,466 shares, Amoskeag took over the effective management of BAR. It acquired a railroad in serious financial condition. Net revenue from operations for the year 1970 was a loss of \$1,313,603. The new manage-

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ment's first task was to turn the railroad around and make it a going, viable common carrier, capable of serving the public which it is required to do.

At the same time, the Interstate Commerce Commission was conducting an analysis of the relationship between BAR, B&A, Punta and Operations as a follow-up to the Bureau of Accounts Special Review of Railroad Conglomerates dated March 11, 1969. Under date of February 1971, the Bureau of Accounts of the Interstate Commerce Commission filed an extensive report with the Interstate Commerce Commission entitled "Review of Diversified Holding Company Relationships and Transactions of Bangor Punta Corporation", which did not become public and, therefore, was not available to the new management of BAR until July 1971. The Bureau of Accounts and Controls recommended that all legal remedies be explored to require the holding company (Operations) which sold the carrier (BAR) to pay back to the carrier the (i) assets taken with no compensation and (ii) charges made where no services were performed. Management of the BAR have reviewed extensively the report of the Bureau of Accounts and Controls and the Inter-corporate relationships in detail. All wrongs hereinafter complained of were discovered by BAR's new management's investigation of all facets of the inter-corporate relationships and were not previously known to the new BAR management.

14. BAR has presently outstanding 179,810 shares of common stock. Of this total, 177,466 shares were purchased by Amoskeag from Operations by agreement effective October 1, 1969, for approximately \$5 million. Since the formation of B&A and the exchange of stock between the BAR and B&A, there have been and are minority stockholder interests which are still outstanding, and many of said minority stockholder interests have been outstanding during the entire period of time covered by this complaint. The

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present minority stockholders of BAR and their names, shares, and dates of respective acquisitions are shown on Schedule A annexed hereto.

15. During all the period of time covered by this Amended Complaint, BAR has had substantial creditors holding BAR obligations, of which the following are indicative, but not necessarily exclusive (principal amounts outstanding as of December 31, 1970):

- (1) \$6,322,000.00 4¼% First Mortgage Series A Bonds, due February 1, 1976.
- (2) \$175,000.00 5¼% First Mortgage Series B Bonds, due June 2, 1973.
- (3) \$2,716,000.00 5½% Income Promissory Notes, due October 1, 1995.
- (4) \$14,455,459.00 of equipment obligations.

16. By reason of Punta's and Operations' domination and control of plaintiff BAR and, through its control of plaintiff BAR, its effective domination and control of plaintiff BIC, Punta and/or Operations stood in a fiduciary capacity as a Trustee for BAR and BIC and for the creditors of both of said plaintiffs and for both the majority and minority stockholders of the BAR and the stockholders of BIC. Standing in this relationship, Punta and Operations, acting through its officers, agents and servants, had the duty when it had dealings with BAR and its wholly-owned subsidiary, BIC, to treat BAR and BIC fairly and to act with regard to the acquisition of the assets of either BAR or BIC only after full disclosure of all material facts then known in each transaction and to use the utmost good faith, and to make a full and adequate accounting and justification of all purchases and inter-corporate charges where Punta and Operations were in a position of majority stockholder to BAR and thus to its wholly-owned subsidiary, BIC, all of which Punta and Operations failed to do.

*Amended Complaint***COUNT I****Corporate Charges—Common Law**

17. During the years 1962 through 1967 B&A and, later, Operations, caused BAR to transfer the following amounts of its cash to B&A and Operations:

<u>Year</u>	<u>Amount</u>
1962 -----	\$ 70,000
1963 -----	96,000
1964 -----	155,000
1965 -----	165,000
1966 -----	204,000
1967 -----	120,000
	<hr/>
	\$810,000 TOTAL

Cash so transferred was stated by Operations and by officers of BAR who were acting to the detriment of BAR to be in payment for legal, accounting and printing services furnished BAR by B&A and Operations and for salaries, wages and travel expenses. In fact, BAR did not, at any time, receive anything other than nominal services from B&A and Operations, which were in no way commensurate with the substantial amounts charged to it. During the same period, BAR provided legal and other services for B&A and Operations for which BAR was not compensated.

18. Though requested to do so by agents of the new management of BAR, representatives of Punta and Operations have never justified the inter-corporate charges set forth in paragraph 17. In addition, the by-laws of the corporation (Article II) required that all contracts in excess of \$5,000 be reported to the board of directors. In the case of the aforesaid corporate charges, this was never done. An analysis of the records of the BAR do not show any

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justification for the inter-corporate charges. The officers of the BAR who authorized the payment of the inter-corporate charges for the amounts set forth in paragraph 19 to B&A and Operations were also officers and Directors of both B&A and Operations and they authorized the payment of same knowing full well there was no justification for said payments, that there were only nominal benefits to BAR for the alleged services from B&A and Operations, and the payment of these inter-corporate charges was concealed and the true nature of same was never revealed to the Board of Directors of BAR so that they could have taken such action as would have been in the interests of BAR.

19. Payment of these corporate charges caused by B&A and Operations constituted a conversion and misappropriation of the cash assets of BAR to the sole use and benefit of B&A and Operations.

COUNT II

Corporate Charges—Maine Public Utilities Law

20. Plaintiff BAR re-alleges the allegations of paragraphs 17-19 (Count I).

21. BAR is a "public utility" as defined in the Maine Public Utilities Act, 35 Maine Revised Statutes Section 15. At the time of these transactions, B&A and Operations owned more than 25% of the common stock of BAR, to wit, at least 80% thereof.

22. All corporate charges paid by BAR as set forth in Count I were paid without prior written approval of the Maine Public Utilities Commission, as required by 35 Maine Revised Statutes Section 104, which provides, *inter alia*:

No public utility doing business in this State shall . . . make any contract or arrangement, providing for the

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furnishing of . . . services . . . with any corporation . . . owning in excess of 25% of the voting capital stock of such public utility . . . unless and until such contract or arrangement shall have been found by the commission not to be adverse to the public interest and shall have received their (sic) written approval. . . .

Failure to obtain such approval rendered the transactions void, so that all payments of corporate charges by BAR to B&A and Operations are void under applicable Maine Law.

COUNT III

St. Croix Paper Stock—Common Law

23. Prior to acquisition of BAR by B&A, BAR's wholly-owned subsidiary, Bangor Investment Company (hereafter, BIC) had acquired shares of the common stock of St. Croix Paper Co. at a cost of \$2,127,000. Of this amount, BIC was indebted in January 1960 to BAR for \$1,927,000 and to a Boston bank for \$200,000.

24. As set forth in paragraph 23, BIC was indebted to the BAR for \$1,927,000 in January 1960 for the purchase of the St. Croix stock. BAR was likewise indebted for all the money that BIC owed BAR as BAR had borrowed same and made it available to BIC, its wholly-owned subsidiary for the purpose of acquiring the St. Croix paper stock. During 1958, when BAR was short of cash, BAR issued \$500,000 in bonds, being the 5¼% First Mortgage Bonds Series B, due June 2, 1973, pursuant to approval by Interstate Commerce Commission based upon representations that the proceeds would be used for railroad purposes. Of the \$500,000 received from the sale of these bonds, \$400,000 was advanced by BAR to BIC, for the express purpose of purchasing more St. Croix stock. Thus, with respect to

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all matters alleged in paragraph 23 and this paragraph, BIC acted as the *alter ego* of BAR and at its discretion and under its control.

25. Commencing September 1962, B&A embarked upon a scheme to obtain for itself the proceeds and benefits from the ownership and disposition of a substantial portion of the 67,789 shares of St. Croix Paper stock owned by BIC. First, B&A caused the directors of BAR to sell BIC's St. Croix stock to B&A in consideration of the following:

- (a) B&A assumed the \$200,000 obligation to the Boston bank.
- (b) B&A issued 10,180 shares of its own stated \$100 par 5% cumulative non-voting preferred to BAR and 4,820 shares of the same preferred to BIC.
- (c) B&A issued its note to BAR in the principal amount of \$427,000 with interest at $4\frac{1}{2}\%$.

B&A agreed with BAR that if the St. Croix Paper stock were sold by B&A at a profit within six months of the date B&A acquired it, B&A would give its note to BAR for the amount of the gain.

26. In January 1963, within 4 months of the date of B&A's acquisition thereof, the St. Croix Paper stock, as a result of a tender offer, was exchanged for 54,231 shares of the stock of Georgia Pacific Corporation (hereafter GP). Plaintiff BAR believes and therefore avers that at the time of the transfer of said 67,789 shares of St. Croix Paper stock by BIC to B&A, negotiations between GP and said St. Croix Paper Co. with respect to the aforesaid tender offer were taking place and were known to B&A but not

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known or disclosed to BAR or BIC directors when they authorized the exchange. The "paper" profit to B&A as a result of these exchanges was approximately \$585,700. B&A then issued its promissory note to BIC in said amount.

27. During 1964, after transfer by BIC to BAR of BIC's 4,820 shares of the aforesaid \$100 par value preferred of B&A, B&A repurchased all of its outstanding \$100 said par value preferred stock from BAR by transferring 27,735 shares of GP stock at a value of \$1,554,114, which was an excess of \$54,114 over the stated par value of the repurchased preferred. To compensate B&A for this difference, BAR paid B&A \$54,114 in cash. BAR also paid B&A an additional \$14,800 cash for 276 additional shares of Georgia Pacific stock transferred to BAR. After such transfer, B&A still owned 33,925 shares of Georgia Pacific stock which it subsequently sold for \$1,995,062. No part of the proceeds of such sale was ever paid to BAR.

28. During the period B&A and its successor, Operations, held GP stock it received cash and stock dividends paid or distributed in respect of GP stock and, in addition, Operations or Punta received 2,203.1425 shares of GP stock as its proportional part of the settlement in *Taylor v. Georgia Pacific Corp.* 67 Civ. 11 USDC SD of N.Y., all which would otherwise have been paid to BIC for BAR's benefit.

29. The foregoing wrongful manipulations of the assets of BAR and BIC, and the conversion and misappropriation thereof by B&A, were done for the sole benefit of B&A to provide it with cash and other assets which would have otherwise been available to BAR. No benefit was derived by BAR or BIC from such manipulations, conversion and misappropriation nor were these acts of B&A motivated or done in the interest of BAR or BIC.

*Amended Complaint***COUNT IV****St. Croix Paper Stock—Clayton Act**

30. Plaintiffs BAR and BIC re-allege the allegations of paragraphs 23-29 above, inclusive (Count III).

31. In September 1962, when the shares of St. Croix Paper stock were transferred from BAR's wholly-owned subsidiary BIC to B&A, and B&A's aforesaid stated \$100 par value preferred shares were transferred by B&A to BAR and BIC, nine of BAR's fourteen directors were also directors of B&A and at least a majority of BIC's directors were directors of B&A.

32. Title 15 United States Code Section 20 (Clayton Act, Section 10) provides, inter alia, as follows:

“(N)o common carrier engaged in commerce shall have any dealings in securities, supplies or other articles of commerce . . . to the amount of more than \$50,000, in the aggregate, in any one year, with another corporation . . . when the said common carrier shall have upon its board of directors or as its president . . . any person who is at the same time a director (or) manager . . . of . . . such other corporation unless . . . such dealings shall be with the bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding.”

33. The transfer of St. Croix Paper stock to B&A and B&A's transfer of its stated \$100 par value preferred stock without compliance with 15 USC Section 20 constituted a violation of said Statute as to which plaintiffs BAR and BIC are entitled by law to obtain treble damages and reasonable counsel fees for the prosecution of this Count pursuant to the provisions of 15 USC Section 15.

*Amended Complaint***COUNT V****St. Croix Paper Stock—Maine Public Utilities Law**

34. Plaintiff BAR re-alleges the allegations of paragraphs 23-29 above, inclusive (Count III).

35. At the time of these transactions, B&A owned more than 25% of the common stock of BAR, to wit, at least 80% thereof.

36. BAR is a "public utility" as defined in the Maine Public Utilities Act 35, MRSA Section 15.

37. BAR's taking of B&A's note in the amount of \$427,000 in paragraph 27 above and payment of \$68,914 in cash by BAR to B&A as set forth in paragraph 27 above, were done without the prior written approval of the Maine Public Utilities Commission and constitute a violation of 35 MRSA Section 104. Failure to obtain such prior approval rendered the aforesaid note and payments void, and hence the entire transaction as set out in paragraphs 23-29 is void.

COUNT VI**St. Croix Paper Stock—Securities Exchange Act
Violation**

38. Plaintiff BAR re-alleges the allegations of paragraphs 23-29 above, inclusive.

39. The transaction involving the transfer of St. Croix Paper stock by BAR's wholly-owned subsidiary BIC to B&A involved the use of "manipulative or deceptive device or contrivance" in connection with the purchase or sale of a security in violation of Section 10b of the Securities Exchange Act, Title 15, USC Section 78(j)(b) and Rule 10b-5 thereunder in that (i) B&A did not disclose to either BAR or BIC that negotiations were taking place between

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GP and St. Croix Paper Company for an exchange of stock, (ii) B&A did not disclose to either BAR or BIC that negotiations were taking place between GP and St. Croix Paper Company for an exchange of stock and that the management of B&A had a pre-conceived plan for disposing of the St. Croix Paper stock that it proposed to keep after ostensibly paying what appeared to be fair compensation to BIC for the St. Croix Paper stock, and (iii) the value of the said stated \$100 par value preferred stock of B&A issued to BIC and BAR in consideration of the St. Croix Paper stock had a value which, even when added to the other consideration received by BIC and BAR, was substantially less than the St. Croix stock transferred by BIC and BAR.

40. The use of such manipulative or deceptive device or contrivance entitles plaintiff BAR or BIC to rescission or, in the alternative, to monetary damages in an equivalent amount.

COUNT VII**Payment of Special Dividends—Common Law**

41. Operations formulated a policy whereby plaintiff BAR would declare special dividends in order to provide working capital for Operations. First, on or about October 13, 1964, the effective date of the merger of B&A and Operations, B&A and Operations caused BAR to declare and pay a special cash dividend of \$2.60 per share. As owner of approximately 98% of the outstanding capital stock of BAR, B&A received said dividend in cash and, in liquidation, was able to transfer cash in the amount of \$336,978.75 to Operations.

42. In July 1966, Operations continued its special dividend policy in order to reduce the substantial indebtedness owed by Operations to BAR. This consisted primarily

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of obligations assumed by Operations upon its merger with B&A, including promissory notes to BAR aggregating \$602,000 and a promissory note to BIC, the wholly-owned subsidiary of BAR, in the amount of \$585,700. To reduce or discharge these notes, Operations caused BAR to pay special dividends in July 1966 and January 1967 each in the amount of \$2.50 per share. Thus, in July 1966, the special dividend declared by BAR reduced Operations debt to it from \$602,000 to \$158,772.50, the dividend being \$443,227.50. Again, on or about January 27, 1967, Operations first caused BIC to declare a dividend of \$585,700 to BAR, consisting, in its entirety, of the promissory note of Operations in that amount held by BIC, and then simultaneously BAR declared a special dividend of \$2.50 of which \$443,340 was applied against the aforesaid note of Operations, leaving a balance due of \$142,360. By payment of these two special dividends, Operations reduced its indebtedness to BAR from \$1,187,700 to \$301,132.50.

43. The declaration and payment of these special dividends by the board of directors of BAR was caused by B&A and Operations misleading and deceiving the BAR directors for the sole and exclusive benefit of Operations. Prudent and informed directors exercising independent judgment with all facts disclosed would never have declared these dividends. The policy served to deprive plaintiff BAR of a source of cash which could and would have been utilized for necessary maintenance and equipment acquisitions and replacements, all to the injury of BAR and the public which it serves.

COUNT VIII**Payment of Special Dividend—Securities Law**

44. Plaintiff BAR re-alleges the allegations of paragraphs 41-43.

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45. Said cancellation of notes and other matters relating to the payment of special dividends constituted a purchase of securities by BAR, and was accomplished by B&A and Operations using manipulative or deceptive devices or contrivances in connection therewith in violation of Section 10b of the Securities Exchange Act, Title 15, USC Section 78(j) (b), and Rule 10b-5 thereunder.

COUNT IX**Borrowing to Pay BAR Dividend—Common Law**

46. The BAR balance sheet as of August 31, 1967, did not meet the requirements governing payment of regular dividends as set forth in the certain Supplemental Bond Indenture of February 1, 1956 between BAR and the Old Colony Trust Company of Boston, Massachusetts, Trustee, relating to 4¼% First Mortgage Bonds of BAR. Specifically, Article 7, Section 11 of said Indenture provided that BAR would not declare or pay any dividends if "after giving effect thereto, Net Working Capital is less than the sum of (y), Fixed Charges for the next ensuing twelve months' period and (z) the then annual sinking fund requirements (on a non-cumulative basis) on all outstanding bonds". As of August 30, 1967, BAR's fixed charges for the next twelve-month period were approximately \$1,300,000 and the sinking fund requirement was \$125,000 so that in order to declare dividends, working capital would have to exceed \$1,425,000 and the dividends so declared could only be in the amount of such excess. The aforesaid balance sheet as of August 31, 1967, showed working capital of only \$1,070,000, and the balance sheet of September 30, 1967, showed working capital reduced to \$795,000.

47. In order to "meet" the dividend requirement of said Indenture on October 30, 1967, BAR's wholly-owned

Amended Complaint

subsidiary, BIC, on or about October 26, 1967, borrowed, on demand, \$1,200,000 from a bank. Immediately thereafter, BIC loaned said amount to BAR for a term of fifteen months. Neither the borrowing by BIC nor the lending of borrowed funds by BIC to BAR were approved by either the directors of BAR or BIC. The loan to BAR of \$1,200,000, ostensibly being for a term in excess of one year, was recorded on BAR's books as a long-term debt and BAR's net working capital was thereby "increased" by \$1,200,000 on its balance sheet as of October 31, 1967. In fact, BAR repaid the loan of \$1,200,000, with interest amounting to \$3,667, on November 15, 1967. After the loan had been repaid and BAR's "working capital" reduced as a result thereof, Operations caused BAR's Executive Committee, on or about December 1, 1967, to declare a regular dividend to be paid on December 29, 1967, in the amount of 20¢ per share, based on the balance sheet of October 31, 1967. The total amount of such dividend was \$35,962, of which Operations received approximately \$35,500.

48. The aforesaid loan of \$1,200,000 was obtained solely for the express purpose of wrongfully appearing to satisfy the dividend restriction contained in the Supplemental Bond Indenture. Payment of said dividend was improper under the Indenture in violation of the duties of the BAR directors to BAR. The scheme constituted a conversion and misappropriation of the assets of BAR.

COUNT X**Borrowing to Pay BAR Dividend—Securities Law**

49. Plaintiff BAR re-alleges the allegations of paragraphs 46-48.

50. Said borrowing and payment of dividend constituted a manipulative or deceptive device or contrivance in

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violation of Section 10(b) of the Securities Exchange Act, Title 15 USC Section 78(j)(b), and Rule 10b-5 thereunder, and constituted a continuance of the underlying scheme to wrongfully deprive BAR of its cash and assets.

COUNT XI

B&A Loan—Common Law

51. In July 1960, B&A caused BAR to loan B&A an aggregate amount of \$75,000, evidenced by two notes, each bearing interest at 5%. On or about November 30, 1960, B&A caused BAR's board of directors to excuse payment of all interest on the loan. Operations assumed the obligations on the loan when B&A was merged into it in 1964. When BAR declared a special dividend on June 15, 1966, the amount of the dividend was applied in reduction of the amount owed by Operations to BAR. No interest was ever paid by B&A or Operations on the two notes.

52. The non-payment of interest with respect to the aforesaid loan was unfair to BAR, did not result from arms-length bargaining and constituted wrongful exploitation by B&A and Operations of BAR for the sole and exclusive benefit of B&A and BAR.

COUNT XII

B&A Loan—Clayton Act

53. Plaintiff BAR re-alleges the allegations of paragraphs 51-52 herein.

54. At the time of making of the aforesaid loan, BAR and B&A had seven common directors and the same president.

55. The aforesaid loan as evidenced by the two aforesaid notes constituted a violation of Section 10 of the Clayton Act (Title 15 USC Section 20) and Plaintiff is entitled to obtain treble damages and reasonable counsel fees for

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the prosecution of this Count pursuant to the provisions of 15 USC Section 15.

COUNT XIII**B&A Loan—Securities Law**

56. Plaintiff BAR re-alleges the allegations of paragraphs 51-52.

57. Said transaction constituted a manipulative or deceptive device or contrivance in violation of Section 10(b) of the Securities Exchange Act, Title 15 USC Section 78(j)(b), and Rule 10b-5 thereunder, in that B&A had no intention of ever repaying the loan or any interest thereon and that this was a part of the underlying scheme to wrongfully deprive BAR of its cash and assets.

WHEREFORE, Plaintiff BAR requests that it have judgment jointly and severally against the Defendants as follows:

- (1) Under Count I for \$810,000.
- (2) Under Count II for \$810,000.
- (3) Under Count III for \$1,995,062 plus \$54,114, plus \$14,800, plus the amounts realized by the defendants on the sale of the 2,203.1425 shares of G.P. stock received in the *Taylor* settlement, less the amount of the obligations B&A assumed in connection with the St. Croix transactions, being \$200,000 plus \$585,700, leaving approximately \$1,500,000 which BAR seeks as judgment on this Count.
- (4) Under Count IV for triple the damage under Count III, totaling approximately \$4,500,000 plus reasonable attorney's fees.
- (5) Under Count V for approximately \$1,500,000.
- (6) Under Count VI for approximately \$1,500,000.
- (7) Under Count VII for \$1,223,546.25.

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- (8) Under Count VIII for \$1,223,546.25.
- (9) Under Count IX for \$39,629.
- (10) Under Count X for \$39,629.
- (11) Under Count XI for fair and reasonable interest on the \$75,000 in loans from the date of making.
- (12) Under Count XII for triple the damages in Count XI, plus reasonable attorneys' fees.
- (13) Under Count XIII for fair and reasonable interest on the \$75,000 in loans from the date of making.
- (14) And, in addition, wherever proper, for interest, fair and reasonable attorneys' fees, costs and such other relief as appears just and equitable.

Dated at Portland, Maine, this 18th day of August, 1972.

BANGOR AND AROOSTOOK RAILROAD
COMPANY

AND

BANGOR INVESTMENT COMPANY

/s/ ROGER A. PUTNAM
Their Attorney

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Amended Complaint

BANGOR AND AROOSTOOK RAILROAD COMPANY ET ALS

VS.

BANGOR PUNTA OPERATIONS, INC. ET ALS

**Schedule A
to Amended Complaint**

<u>Stockholder</u>	<u>Number of Shares</u>	<u>Date of Acquisition</u>
Harry N. Ball -----	50	5/29/56
Bangor Punta Operations, Inc. ---	26	8/ 8/71
Adele Bevilacqua -----	32	2/20/65
Dorothy H. Corbett -----	300	12/ 4/45
	15	4/ 1/55
Thomas C. Corbett -----	300	3/ 5/56
Mrs. Ruth M. Fox -----	1	4/ 1/55
Wilbar M. Hoxie -----	2	8/ 9/49
Murray Kaplan -----	100	12/10/59
Carl Lehr -----	5	12/ 1/60
Theodore N. Levin -----	5	7/ 7/66
Carl M. Sangree, Jr. -----	9	3/ 5/56
Donald B. Smith, Jr. -----	2	6/21/61
Mrs. Ruth M. Sprague -----	5	4/ 1/55
Stuart R. Stevenson -----	3	1/17/63
Archibald Roy Thomson, Jr. -----	1	8/26/65
Tweedy, Browne & Knapp -----	1	2/ 3/71
Mrs. Beverly M. Wiggert -----	67	10/ 5/65
Mrs. Edith E. Wiggert -----	50	9/12/51
	30	10/31/51
	4	4/ 1/58

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<u>Stockholder</u>	<u>Number of Shares</u>	<u>Date of Acquisition</u>
Mrs. Jeannie E. Wiggert -----	15	10/ 5/65
Harry H. Wiggert -----	50	11/15/51
	50	4/ 7/54
	5	4/ 1/55
	26	8/26/64
John Clayton Wiggert -----	20	9/12/51
	30	12/ 3/51
	50	11/15/51
	5	4/ 1/55
	26	8/26/64
Mrs. Mabel A. Wiebke -----	10	2/15/34

UNITED STATES DISTRICT COURT
DISTRICT OF MAINE

<p>BANGOR AND ABOOSTOOK RAILROAD COMPANY AND BANGOR INVESTMENT COMPANY, —against— BANGOR PUNTA OPERATIONS, INC. AND BANGOR PUNTA CORPORATION, <i>Defendants.</i></p>	<p><i>Plaintiffs,</i></p>	<p>Civil Action No. 1933</p>
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ANSWER

The defendants Bangor Punta Corporation ("Bangor Punta") and Bangor Punta Operations, Inc. ("BPO") for their answers to the amended complaint, allege as follows:

FIRST: Deny each and every allegation contained in Paragraph 1.

SECOND: Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph 2, except admit that BAR is a Maine corporation organized in 1891 with its principal place of business in Bangor, Maine, and is engaged principally in the railroad business.

THIRD: Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph 3, except admit that between 1960 and October 2, 1969, BAR owned all of the outstanding capital stock of BIC and BIC is a Maine corporation.

Answer of Defendants

FOURTH: Admit the allegations of Paragraph 9, except deny knowledge or information sufficient to form a belief as to the truth of the allegation that the BAR was formed upon the advice of Salgo.

FIFTH: Admit the allegations of Paragraph 10, except deny the allegations relating to the terms and conditions of the Agreement between BAC and Bangor Punta and the Court is respectfully referred to the Agreement between BAC and Bangor Punta for the terms and conditions thereof, and deny knowledge and information sufficient to form a belief as to the truth of the allegation that BAC sold its assets upon the advice of Salgo.

SIXTH: Deny each and every allegation contained in paragraphs 11 and 12.

SEVENTH: Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph 13, except admit that effective as of October 1, 1969 Amoskeag acquired 177,466 shares (or 98.3%) of the Common Stock of BAR from BPO and Bangor Punta, Amoskeag took over the effective management of BAR as of October 1, 1969 and there is a report entitled "Review of Diversified Holding Company Relationships and Transactions of Bangor Punta Corporation".

EIGHTH: Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph 14, except admit that Amoskeag purchased 177,466 shares of Common Stock of BAR from BPO and Bangor Punta by an agreement effective as of October 1, 1969 for approximately \$5 million, there were minority stockholders (1.7%) of the BAR prior to October 1, 1969 and BPO is the owner of 26 BAR shares as reflected in Schedule A.

Answer of Defendants

NINTH: Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph 15, except admit that BAR had creditors during the period of time covered by the amended complaint.

TENTH: Deny each and every allegation contained in Paragraph 16.

ELEVENTH: Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph 17.

TWELFTH: Deny each and every allegation contained in Paragraphs 18 and 19.

THIRTEENTH: Repeat and reiterate their answers as set forth in Paragraphs *Eleventh* and *Twelfth* herein to the allegations of Paragraph 20.

FOURTEENTH: Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph 22.

FIFTEENTH: Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraphs 23, 24, 25, 26, 27, 28, 29, 30 and 31.

SIXTEENTH: Deny each and every allegation contained in Paragraph 33.

SEVENTEENTH: Repeat and reiterate their answers as set forth in Paragraph *Fifteenth* herein to each and every allegation in Paragraph 34.

EIGHTEENTH: Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph 37.

Answer of Defendants

NINETEENTH: Repeat and reiterate their answers as set forth in Paragraph *Fifteenth* herein to each and every allegation in Paragraph 38.

TWENTIETH: Deny each and every allegation contained in Paragraphs 39 and 40.

TWENTY-FIRST: Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraphs 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51 and 52.

TWENTY-SECOND: Repeat and reiterate their answers as set forth in Paragraph *Twenty-first* herein in respect of Paragraphs 51 and 52 to each and every allegation in Paragraphs 53 and 56.

TWENTY-THIRD: Deny each and every allegation contained in Paragraphs 55 and 57.

As and For a First Affirmative Defense

TWENTY-FOURTH: The causes of action alleged in the complaint are barred by the applicable statutes of limitations.

As and For a Second Affirmative Defense

TWENTY-FIFTH: The complaint fails to state a cause of action.

As and For a Third Affirmative Defense

TWENTY-SIXTH: The Amoskeag Company having purchased approximately 99% of the BAR shares from Bangor Punta subsequent to the acts alleged herein, plaintiffs are estopped from maintaining this action.

*Answer of Defendants***As and For a Fourth Affirmative Defense**

TWENTY-SEVENTH: Plaintiffs had notice of all of the facts and all of the acts of the defendants set forth in the complaint and nevertheless have refrained from commencing this action until December 31, 1971 and have thereby been guilty of such laches as should in equity bar the plaintiffs from maintaining this action.

As and For a Fifth Affirmative Defense

TWENTY-EIGHTH: Plaintiffs, with full knowledge of all of the facts relating to the transactions alleged in the complaint, duly ratified and affirmed the acts of the defendants alleged in the complaint.

As and For a Sixth Affirmative Defense

TWENTY-NINTH: Plaintiffs do not have the capacity to maintain this action.

Dated: Portland, Maine
September 15, 1972

BERNSTEIN, SHUB, SAWYER & NELSON

By _____
Attorneys for Defendants

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UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

NORTHERN DIVISION

BANGOR AND AROOSTOOK RAILROAD
COMPANY AND BANGOR INVESTMENT
COMPANY,

*Plaintiffs,**v.*

BANGOR PUNTA OPERATIONS, INC. AND
BANGOR PUNTA CORPORATION,

Defendants.

Civil Action,
Docket
No. 1933

Motion For Summary Judgment

The Defendants respectfully move that summary judgment be granted in favor of the Defendants pursuant to F.R.C.P. Rule 56(b):

(1) By dismissing the entire complaint, as amended, herein, with prejudice, for the reason that the complaint fails to state a cause of action on behalf of the corporate Plaintiffs; or, in the alternative,

(2) By dismissing each of Count II and Count V of the amended complaint herein, with prejudice, for the reason that each of them fails to state a cause of action.

The Defendants' Memorandum of Law in support of this Motion dated September 15, 1972, is herewith submitted.

Dated at Portland, Maine, this fifteenth day of September, A.D. 1972.

BANGOR PUNTA OPERATIONS, INC.

and

BANGOR PUNTA CORPORATION

/s/ HERBERT H. SAWYER

Attorney for the Defendants

BEENSTEIN, SHUB, SAWYER &
NELSON

One Monument Square
Portland, Maine 04111

December 29, 1972, District Court Opinion

BANGOR AND AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,

Plaintiffs,

v.

BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,

Defendants.

Civ. No. 1933.

UNITED STATES DISTRICT COURT

D. MAINE, N. D.

DECEMBER 29, 1972.

OPINION AND ORDER OF THE COURT

GIGNOUX, *District Judge.*

This action arises under the Securities Exchange Act of 1934, the Clayton Antitrust Act, the Maine Public Utilities Act, and the common law of Maine. Plaintiff Bangor and Aroostook Railroad Company (BAR) is a Maine corporation which operates a railroad in the northern part of the State of Maine. Plaintiff Bangor Investment Company (BIC), a Maine corporation, is a wholly-owned subsidiary of BAR. Defendant Bangor Punta Corporation (Bangor Punta), a Delaware corporation, is a diversified holding company with operating units in various industries. Defendant Bangor Punta Operations, Inc. (BPO), a New York corporation, is a wholly-owned subsidiary of Bangor Punta. On October 13, 1964, Bangor Punta, through its wholly-owned subsidiary BPO, became the owner of approximately 98.3% of the stock of BAR when BPO acquired all the assets of Bangor and Aroostook Corporation (BAC), a Maine

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holding company which BAR had caused to be formed in 1960. From October 13, 1964 until October 2, 1969, Bangor Punta owned through BPO approximately 98.3% of all the outstanding stock of BAR. On October 2, 1969, BPO sold all its stock interest in BAR to Amoskeag Company (Amoskeag), a Delaware investment company controlled by Frederic C. Dumaine, Jr., for a consideration of approximately \$5,000,000. Subsequently, Amoskeag has purchased additional BAR shares, and now owns over 99% of all the outstanding capital stock of BAR.

The complaint contains thirteen counts and seeks damages totaling approximately \$7,000,000 for misappropriation and waste of corporate assets alleged to have been caused to BAR by four intercompany transactions, which allegedly took place between BAC or Bangor Punta and BAR during the period between 1960 and 1967, while BAC and then Bangor Punta were in control of BAR. Counts I and II are brought, respectively, under the common law of Maine (Count I) and Section 104 of the Maine Public Utilities Act (35 M.R.S.A. § 104) (Count II). They charge that BAC, and later BPO, improperly charged BAR for nominal legal, accounting, printing and other services furnished BAR by BAC and BPO. Counts III, IV, V and VI are brought, respectively, under the common law of Maine (Count III); Section 10 of the Clayton Antitrust Act (15 U.S.C. § 20) (Count IV); Section 104 of the Maine Public Utilities Act (Count V); and Section 10(b) of the Securities Exchange Act (15 U.S.C. § 78j(b)) and Rule 10b-5 (17 C.F.R. § 240.10b-5) promulgated thereunder by the Securities and Exchange Commission (Count VI). They are based upon the charge that BAC improperly acquired St. Croix Paper Company stock owned by BAR through its wholly-owned subsidiary BIC. Counts VII, VIII, IX and X are brought, respectively, under the common law of Maine (Counts VII and IX); and Section 10(b) of the Securities

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Exchange Act and Rule 10b-5 thereunder (Counts VIII and X). They charge that BAC and BPO improperly caused BAR to declare special dividends to its stockholders, including BAC and BPO, and improperly caused BIC to borrow so as to satisfy certain balance sheet ratios required by an earlier loan agreement in order to pay a regular dividend. Counts XI, XII and XIII are brought, respectively, under the common law of Maine (Count XI); Section 10 of the Clayton Antitrust Act (Count XII); and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder (Count XIII). They allege that BAC improperly caused BAR to excuse payment by BAC and BPO of the interest due on a loan made by BAR to BAC. In substance, the complaint alleges that Bangor Punta and its predecessor in interest, BAC, while they were in control of BAR through ownership of 98.3% of its stock, "calculatedly drained the resources of BAR in violation of law for their own benefit" during the period between 1960 and 1967, prior to the time Amoskeag purchased Bangor Punta's interest in BAR.

Presently before the Court is defendants' motion for summary judgment dismissing the entire complaint, or in the alternative dismissing the two counts brought under the Maine Public Utilities Act (Counts II and V). Defendants seek dismissal of the entire complaint on the ground that Amoskeag, which would be the sole beneficiary of any recovery by the corporate plaintiffs, was not a stockholder of BAR at the time of the alleged improper transactions and itself has sustained no injury as a result thereof. The Court agrees. Since the Court therefore concludes that the entire complaint must be dismissed, it does not reach defendants' alternative motion for dismissal of Counts II and V.

It is true that, as plaintiffs assert, the present action is an action brought by the corporate plaintiffs in their own

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right, and does not purport to be a derivative action on behalf of either Amoskeag or the 1% minority stockholders in BAR. But, looking at the substance of the action, it is evident that the real party in interest is Amoskeag, the present owner of over 99% of the outstanding BAR shares. And having purchased the stock of BAR from Bangor Punta in 1969, long after the events complained of occurred, Amoskeag is clearly attempting, by having the corporations which it controls bring the action in their names, to recover the full \$5,000,000 consideration paid to Bangor Punta for the BAR shares, plus \$2,000,000 more, while still keeping the BAR shares. Amoskeag does not claim that it was deceived or defrauded by Bangor Punta when it purchased its BAR stock, or that it did not get full value for its purchase price. Nor do plaintiffs claim to bring this action on behalf of any creditors or in the public interest. It would accordingly be contrary to settled equitable principles to permit Amoskeag, by thus using the corporate fiction, to acquire a windfall for any past misbehavior on the part of Bangor Punta during the period when Amoskeag had no interest in BAR and sustained no injury, direct or indirect, as a result of Bangor Punta's alleged improper acts.

Plaintiffs admit that the alleged wrongs took place before Amoskeag purchased its BAR stock from Bangor Punta. Under these circumstances, there can be little doubt that Amoskeag would be barred from maintaining a derivative suit on behalf of BAR for the wrongs alleged to have occurred before Amoskeag purchased its BAR shares. As to the claims asserted under the Securities Exchange Act and the Clayton Antitrust Act, Fed.R.Civ.P.23.1 would apply and in terms requires contemporaneous ownership for maintenance of a stockholder derivative action. *Surowitz v. Hilton Hotels Corp.*, 342 F. 2d 596, 604 (7th Cir.

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1965); *Gottesman v. General Motors Corp.*, 28 F.R.D. 325 (S.D.N.Y.1961). To the extent that plaintiffs' claims arise under state law, jurisdiction being based upon diversity of citizenship, there is doubt as to whether the federal rule or state law applies. See 3B Moore's Federal Practice (2d ed. 1969) ¶ 23.1.15[2]. The majority of states, however, also have adopted the contemporaneous ownership rule, either by judicial decision or by statute. *Id.* at note 6. And even in those cases where the rule has not been applied, it has been held that a subsequent shareholder cannot sue where, as in the present case, he acquired his stock from the alleged wrongdoer, who himself would have been barred by his participation and acquiescence.¹ See, e. g., *Bloodworth v. Bloodworth*, 225 Ga. 379, 387, 169 S.E.2d 150, 156-157 (1969); *Babcock v. Farwell*, 245 Ill. 14, 40-41, 91 N.E. 683, 692-693 (1910); *Home Fire Insurance Co. v. Barber*, 67 Neb. 644, 661-662, 93 N.W. 1024, 1030-1031 (1903); *Bookman v. R. J. Reynolds Tobacco Co.*, 138 N.J.Eq. 312, 372, 48 A.2d 646, 680 (Ch.1946). Plaintiffs instituted the present suit two days prior to the effective date of the new Maine Business Corporation Act, which adopts the contemporaneous ownership rule, 13-A M.R.S.A. § 627(1)(A) (1972). It is an open question in Maine whether the contemporaneous ownership rule applied at the time the present suit was brought. See *Field, McKusick & Wroth*, Maine

1. Plaintiffs allege no facts which would support the allegation in their complaint that "[t]he injury to BAR is a continuing one surviving the aforesaid sale [from BPO] to Amoskeag." There is thus no basis for any suggestion that they may rely upon the "continuing wrong" exception to the contemporaneous ownership rule, which permits a subsequent stockholder to maintain a derivative suit if the alleged wrongful acts and their effects continue and are injurious to to him. Moreover, there is serious question as to whether such an exception should be recognized at all. Compare *Duncan v. National Tea Co.*, 14 Ill.App.2d 280, 144 N.E.2d 771, 775 (1957) with *Weinhaus v. Gale*, 237 F.2d 197, 199-200 (7th Cir. 1956); *Bowman v. Alaska Airlines*, 14 Alaska 62, 14 F.R.D. 70, 72 (1952).

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Civil Practice (2d ed. 1970) § 23.2 at 393.² But there is no indication in the Maine cases that the Maine court would not have followed the prevailing rule. In such situations, where the law of the particular state is not shown to be in conflict with the federal rule, federal courts will apply Rule 23.1. *Gallup v. Caldwell*, 120 F.2d 90, 94-95 (3rd Cir. 1941); *Mullins v. DeSoto Securities Co.*, 45 F.Supp. 871, 878 (W.D.La.1942); see 3B Moore's Federal Practice, ¶ 23.1-15[2] at n. 13. Thus, whether the federal rule or Maine law is applicable, Amoskeag could not maintain a derivative action against the defendants.

From the foregoing, it is evident that Amoskeag, by causing the plaintiff corporations to bring this action, is attempting to accomplish indirectly what it could not do directly. Plaintiffs contend that the Court cannot look beyond the corporate form to the substance of the corporate claims and the true beneficiary thereof. But the four inter-company transactions that are the basis of plaintiffs' claims are typical stockholder claims seeking an accounting for alleged misappropriation and waste of corporate assets by controlling stockholders. Equitable considerations must be applied in such actions. *Amen v. Black*, 234 F.2d 12 (10th Cir. 1956); *Matthews v. Headley Chocolate Co.*, 130 Md. 523,

2. Defendants point to *Hyams v. Old Dominion Co.*, 113 Me. 294, 93 A. 747 (1915) as indicating the new Maine Business Corporation Act merely codified pre-existing Maine law. In that case, the defendant objected that the plaintiff could not complain because the wrong, if any, was done before he became a stockholder. The court said: "One answer to this, and a sufficient one, is that the wrong is a continuing one." 113 Me. at 302, 93 A. at 750. See also *Jeffs v. Utah Power and Light Co.*, 136 Me. 454, 465 12 A.2d 592 (1940). Although it can be argued that by applying the continuing wrong exception to the contemporaneous ownership rule, see note 1, *supra*, the Maine court impliedly acknowledged that Maine law required contemporaneous ownership in shareholder actions, the court's cryptic statement is indeed "too enigmatic to be very helpful." Field, McKusick and Wroth, Maine Civil Practice, *supra*.

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100 A. 645 (1917); *Home Fire Insurance Co. v. Barber, supra*. Nor does characterizing the actions as claims arising under federal statutes save them from the scrutiny of equity. *Columbia Nitrogen Corp. v. Royster Co.* 451 F.2d 3, 15-16 (4th Cir. 1971) (antitrust laws); *Royal Air Properties, Inc. v. Smith*, 312 F.2d 210, 213-214 (9th Cir. 1962) (securities laws). See also *Edwin L. Wiegand Co. v. Harold E. Trent Co.*, 122 F.2d 920, 925 (3rd Cir. 1941) (copyright laws). The equitable principle that the corporate form "will not be allowed to be pushed to the extent of furthering injustice rather than justice" is well established, and has been applied to cases where the plaintiff attempted to use the corporate form to achieve results which he could not accomplish in his own right. *Western Battery & Supply Co. v. Hazelett Storage Battery Co.*, 61 F.2d 220, 230 (8th Cir. 1932), cert. denied, 288 U.S. 608, 53 S.Ct. 399, 77 L. Ed. 982 (1933); *Shamrock Oil and Gas Co. v. Ethridge*, 159 F.Supp. 693 (D. Colo. 1958). Since Amoskeag, which did not itself incur any damage as a result of defendants' alleged wrongful acts, and not the corporate plaintiffs, is the real beneficiary of any recovery which might be had in the name of the corporate plaintiffs, the corporate claims must fail for lack of equity on the part of those who would ultimately benefit from any corporate recovery.

The applicable principle was stated long ago by Dean Roscoe Pound, then a Commissioner of the Supreme Court of Nebraska, in the leading case of *Home Fire Insurance Co. v. Barber, supra*:

Where a corporation is not asserting or endeavoring to protect a title to property, it can only maintain a suit in equity as the representative of its stockholders. If they have no standing in equity to entitle them to the relief sought for their benefit, they cannot obtain such relief through the corporation or in its own name. (citations omitted). It would be a reproach to courts

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of equity if this were not so. If a court of equity could not look behind the corporation to the shareholders, who are the real and substantial beneficiaries, and ascertain whether these ultimate beneficiaries of the relief it is asked to grant have any standing to demand it, the maxim that equity looks to the substance, and not the form, would be very much limited in its application. 67 Neb. at 664-665, 93 N.W. at 1031-1032.

In *Home Fire*, the court sustained a corporate claim, which it considered to be brought at law, to recover company monies wrongfully withdrawn by Barber and converted to his own use. But the court denied recovery by the corporation upon claims, which it considered to be brought in equity, for corporate mismanagement and waste allegedly committed by Barber, where the existing stockholders, who would be the real beneficiaries of a recovery, had acquired their stock subsequent to the acts complained of, and were hence found to have no standing in equity.

The case of *Amen v. Black*, *supra*, presented facts similar to the instant case. In *Amen*, a corporation, through its receivers, asserted claims for recovery of the profits allegedly realized by Black, its former president and chairman of the Board, from the improper use of company funds and from the sale of corporate stock which Black had wrongfully obtained from the corporation and later sold to N.C.R.A. The court denied relief to the corporation, holding:

Looking at the substance of the corporate claims and the beneficiaries thereof, it becomes readily apparent that the principal beneficiary of any recovery on behalf of the corporation would be the N.C.R.A. who became the principal stockholder upon the purchase of a majority of the stock in 1947. And having

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purchased the stock of the corporation from Black in an arms length transaction, and having received the full value of its purchase, any recovery as stockholder beneficiary of the dissolved corporation would be tantamount to recoupment of the legitimate purchase price of the stock. Obviously there are no equities in such a result, and we therefore hold that the corporate claims must fail for lack of standing to maintain the suit and for want of equity on the part of the beneficiaries in any corporate recovery. 234 F.2d at 23.

Similarly, in *Matthews v. Headley Chocolate Co.*, *supra* Headley Chocolate Company commenced an action against Matthews and six other former directors and controlling shareholders to recover damages for the alleged wrongful misappropriation of corporate assets. Subsequent to the alleged wrongs, Matthews had sold a controlling interest in the corporation to one Rodda and his associates. After concluding that Rodda would be barred from maintaining a derivative action, the court stated:

The question then is whether this bill can be sustained in the name of the corporation, and, if so, how the defendants can be protected from claims we have spoken of as not entitled to relief. Inasmuch as by the change of the majority of stock those who were minority stockholders at the time of the transactions complained of are now able to have the suit brought in the name of the company, we are of the opinion that it can be maintained, in that name, instead of in the names of the minority stockholders but for their benefit. But while that is so, if there be any recovery by reason of the claims spoken of, it can only be to the extent of the proportions of the sum recovered due such minority stockholders, if any, as are not barred by

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laches, limitations, acquiescence, or other way sufficient to bar them in equity, and anything recovered should be directed to be paid to them by the corporation. Any defense that could have been made against the minority stockholders if they had sued in their own names should be allowed, notwithstanding the fact that the suit is in the name of the corporation. It seems to us that that course is the only one which in equity and justice can be adopted in this case. The purchasers from Matthews have lost nothing, so far as the bill discloses, and if he deceived them in the sale, they have their remedy against him individually, but they should not be permitted to use the corporate name to veil defects in the title to the stock transferred to them by the former stockholder who received about two-thirds of the amounts claimed to have been improperly paid. 130 Md. at 536-537, 100A. at 651.

Thus, the court in *Headley Chocolate*, while holding that the corporation had standing to sue, held it could recover only for those minority stockholders who held their shares at the time of the alleged wrongs and who were not barred by any equitable defenses. In the present case, plaintiffs have expressly disclaimed that they are seeking a proportionate recovery on behalf of the 1% minority stockholders in BAR.

The principle that a suit cannot be brought by a corporation where the ultimate beneficiaries of a corporate recovery would be barred was also applied in *Capitol Wine and Spirit Corp. v. Pokrass*, 277 App. Div. 184, 98 N.Y.S.2d 291 (1st Dep't. 1950), aff'd, 302 N.Y. 734, 98 N.E.2d 704 (1951).

Research has disclosed no case the holding of which is contrary to that of the foregoing authorities. In *Central*

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Railway Signal Co. v. Longden, 194 F.2d 310 (7th Cir. 1952), cited by plaintiffs, the court found that there had been no change of ownership of the plaintiff corporation subsequent to the time of the acts complained of. *Id.* at 321. The court's comments on the present question were dictum unnecessary to the decision of the case, and in any event the court seems to be saying no more than that Fed. R.Civ.P. 23 (b) (the predecessor of Rule 23.1) does not apply to a suit by a corporation. *Idem.* Furthermore, it does not appear that Longden, the alleged wrongdoer, was a controlling stockholder, or that the owner of 99% of plaintiffs' stock at the time of suit had acquired its shares from stockholders who had participated in Longden's wrongdoing.

Plaintiffs' final argument is that defendants are in no position to assert equity because if recovery is here denied defendants will be able to keep the fruits of their allegedly wrongful acts. The same argument was made by the plaintiff and rejected by the court in *Home Fire Insurance Co. v. Barber*, *supra*. In the words of Dean Pound:

But it is said the defendant Barber, by reason of his delinquencies, is in no position to ask that the court look behind the corporation to the real and substantial parties in interest. . . . We do not think such a proposition can be maintained. It is not the function of courts of equity to administer punishment. When one person has wronged another in a matter within its jurisdiction, equity will spare no effort to redress the person injured, and will not suffer the wrongdoer to escape restitution to such person through any device or technicality. But this is because of its desire to right wrongs, not because of a desire to punish all wrongdoers. If a wrongdoer deserves to be punished, it does not follow that others are to be enriched at his expense by a court

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of equity. A plaintiff must recover on the strength of his own case, not on the weakness of the defendant's case. It is his right, not the defendant's wrongdoing, that is the basis of recovery. When it is disclosed that he has no standing in equity, the degree of wrongdoing of the defendant will not avail him. 67 Neb. at 673, 93 N.W. at 1035.

For the reasons stated, defendants' motion for summary judgment dismissing the entire complaint is granted.

It is so ordered.

NOTICE OF APPEAL

UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

NORTHERN DIVISION

**BANGOR AND AROOSTOOK RAILROAD
COMPANY AND BANGOR INVESTMENT
COMPANY,**

Plaintiffs,

v.

**BANGOR PUNTA OPERATIONS, INC. AND
BANGOR PUNTA CORPORATION,**

Defendants.

Civil Action,
Docket
No. 1933

Notice is hereby given that Bangor and Aroostook Railroad Company and Bangor Investment Company, Plaintiffs above named, hereby appeal to the United States Court of Appeal for the First Circuit from the order of the District Court granting Defendants' motion for summary judgment dismissing the entire complaint entered in this action on the 29th day of December 1972.

January 17, 1973

/s/ ROGER A. PUTNAM
Counsel for Plaintiffs

VERBIL DANA PHILBRICK
PUTNAM & WILLIAMSON
57 Exchange Street
Portland, Maine 04111
207-774-4573

UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

NORTHERN DIVISION

BANGOR AND AROOSTOOK RAILROAD
COMPANY AND BANGOR INVESTMENT
COMPANY,

*Plaintiffs,**vs.*

Civil Action
No. 1933

BANGOR PUNTA OPERATIONS, INC. AND
BANGOR PUNTA CORPORATION,

*Defendants.***Affidavit**

STATE OF MAINE
COUNTY OF PENOBSCOT } ss.:

WILLIAM M. HOUSTON, being duly sworn, deposes and
says:

1. I am presently Vice President and General Counsel of the Bangor and Aroostook Railroad Company (hereafter BAR). I am a member of the Maine and Massachusetts Bars and have been since 1954. I am also the Clerk of BAR. I was the Assistant Clerk of BAR from 1956 to 1966, at which time I was elected Clerk and have been employed by the BAR since 1955.

2. I have regularly attended Board meetings of the BAR since 1955 and know the Directors of BAR by sight and by name.

3. As of the date of the last Board meeting (December 8, 1971) there were 17 Directors of the BAR. Their names,

Affidavit of William M. Houston

the dates they began to serve as Directors and the dates of any resignations are as follows:

(a)

	<u>Elected</u>	<u>Resigned</u>
W. Gordon Robertson -----	1953	2- 1-1972*
Fred L. Putnam -----	1940	
W. Jerome Strout -----	1956	
George H. Seal -----	1960	1- 6-1972**
William E. Hill -----	1962	1-12-1972**
Wendell L. Phillips -----	1963	
Joseph R. LaPointe -----	1965	
John R. McPike -----	1967	
Richard K. Warren -----	1967	
Jack Roth -----	1968	
Thomas E. Houghton, Jr. --	1968	
Frederic C. Dumaine, Jr. ---	1969	
Dudley B. Dumaine -----	1969	
Roger B. Prescott, Jr. -----	1969	
Harry C. Wood -----	1960	1-10-1972**
Lawrence A. Thibodeau ----	1970	
Thomas S. Pinkham -----	1970	

* Serves as General Trustee of Bangor Punta Employees Profit Sharing Plan and Trust.

** Director of Bangor Punta Corporation.

4. Since the Amoskeag Company purchased some 99% of the BAR stock from Bangor Punta Corporation in October 1969, the question of possible legal proceedings against Bangor Punta Corporation had been discussed by the BAR Board twice at official meetings, once on July 29, 1971 and once on December 8 1971. I was personally present at both meetings.

Affidavit of William M. Houston

5. Present at the first meeting were the following Directors:

Frederic C. Dumaine, Jr.	Wendell L. Phillips
Dudley B. Dumaine	Joseph R. LaPointe
W. Gordon Robertson	John R. McPike
Fred L. Putnam	Thomas E. Houghton, Jr.
W. Jerome Strout	Roger B. Prescott, Jr.
George H. Seal	Harry C. Wood
William E. Hill	Lawrence A. Thibodeau
	Thomas S. Pinkham

6. At this meeting the report of the Bureau of Accounts of the Interstate Commerce Commission, dated February 1971, and entitled "Review of Diversified Holding Company Relationships and Transactions of Bangor Punta Corporation" was discussed. The Board was presented with a resolution which would have authorized its officers to take such action as might be necessary to recover for the BAR such assets as were unlawfully taken from it by Bangor Punta Corporation. Certain members of the Board were not familiar with the ICC report. Accordingly, the Clerk was instructed to send a copy of the ICC report to all Directors, with the understanding that the matter would be acted upon prior to the end of 1971. Also, at the request of certain Directors, this item was not made a part of the Minutes of that meeting. The report was mailed by me to all Directors on August 26, 1971.

7. Present at the second meeting were the following Directors:

Frederic C. Dumaine, Jr.	John R. McPike
D. B. Dumaine	Roger B. Prescott
W. Jerome Strout	Harry C. Wood
Wendell L. Phillips	Thomas S. Pinkham
Joseph R. LaPointe	Richard K. Warren

Affidavit of William M. Houston

8. Also present was Mr. Roger A. Putnam, Esq. Mr. Putnam went over, paragraph by paragraph, a proposed form of Complaint against Bangor Punta. I had personally mailed out to all Directors of the BAR six (6) days before the meeting a copy of this draft, notifying all Directors that at the meeting to be held on December 8, 1971 at Bangor, consideration would be given to the authorization of legal action on behalf of BAR vs Bangor Punta Corporation and related companies. This draft is substantially the same as the actual Complaint filed in this case. Mr. Putnam discussed in detail the legal and factual phases of the case.

9. Following Mr. Putnam's presentation, Mr. Frederic C. Dumaine, Jr. introduced a resolution concerning litigation against Bangor Punta Corporation. Following some discussion and some amendments, the resolution was adopted unanimously. An accurate copy of this resolution is attached to my Affidavit marked Exhibit A.

/s/ WILLIAM M. HOUSTON

Sworn to before me this 17th day
of February, 1972.

/s/ M. LUCILLE BRIMMER
Notary Public

*Affidavit of William M. Houston***Exhibit A**

VOTED, That the Chief Executive Officer of this corporation be and he hereby is authorized for and in its behalf, at such time as he may determine upon advice of legal counsel, to commence and conduct litigation against Bangor Punta Corporation and its subsidiary, Bangor Punta Operations, Inc., which litigation shall be based upon the alleged wrongful acts of said Bangor Punta Corporation and its said subsidiary while they or their predecessor or predecessors owned and controlled this corporation; and that said chief executive officer, any vice president, or the treasurer of this corporation be and each hereby is authorized to execute for and in behalf of this corporation, upon advice of legal counsel, all pleadings, affidavits, motions, notice and other documents requiring execution by an officer of this corporation and relating to the maintenance and prosecution of said litigation.

AFFIDAVIT OF FREDERIC C. DUMAINE, JR.**UNITED STATES DISTRICT COURT**

**DISTRICT OF MAINE
NORTHERN DIVISION**

Frederic C. Dumaine, Jr., being duly sworn, says:

(1) My name is Frederic C. Dumaine, Jr. I am presently president and a director of The Amoskeag Company ("Amoskeag") and also chief executive officer and a director of the Bangor and Aroostook Railroad Company ("BAR"). I have been employed by Amoskeag since 1914 and have held my present positions with Amoskeag since 1951.

(2) I expressly deny that this lawsuit resulted from a personal vendetta of mine. I have no desire to harass or to embarrass the defendants.

(3) On a business level my company, Amoskeag, has been a stockholder in Bangor Punta Corporation ("Punta") from 1964 to 1970. In 1965 Amoskeag made a \$5,000,000 loan to Punta in connection with which Amoskeag got some conversion privileges to convert the debt into stock of Punta. Amoskeag later exercised these rights and realized substantial profit.

(4) On a personal level I consider myself an old friend of Curtis Hutchins, who has been a director of Punta since 1964 and also a large shareholder in Punta. We have known each other around twenty years. We frequently lunch or dine together and have exchanged visits to each other's homes. Mr. Hutchins and I represented our respective companies in the negotiations in 1969 that lead to the sale of the BAR by Punta to Amoskeag.

(5) Also I consider myself a friend of Gordon Robertson, who was president of the BAR in 1960-1962 and who

Affidavit of Frederic C. Dumaine, Jr.

was also president of Punta from 1964-1966 and a director of Punta through 1969. Mr. Robertson has been a director of the BAR from 1960 up until his recent resignation.

(6) Further when Amoskeag acquired the BAR in 1969 from Punta, all the directors who had served under Punta continued to serve as directors including three gentlemen who were also serving as directors of Punta, Harry C. Wood, George H. Seal, and William E. Hill.

(7) While I was a witness called by the S.E.C. in the case *S.E.C. v. Bangor Punta Corporation*, 70 Civ. 3940 (S.D.N.Y.), I was not an active participant in that law suit. The S.E.C. sought me out. It sent people to the Amoskeag offices here in Boston to interview me, and I testified in response to a subpoena.

(8) While I had had some prior inklings that all was not right with the BAR, I never seriously considered suing Punta until after my attorneys called my attention to the L.C.C. report on Punta's dealings with the BAR, published last summer.

(9) After that I directed Amoskeag's general counsel, Ely, Bartlett, Brown & Proctor to investigate the matter and, at their suggestion, also retained Mr. Roger A. Putnam of Verrill, Dana, Philbrick, Putnam, & Williamson as Maine counsel.

(10) Later I asked the firm of McGuire, Woods & Battle of Charlottesville, Virginia, to review the work and the conclusions of these other lawyers.

(11) In December, 1971, Curtis Hutchins contacted me and asked if he and some other people from Punta could meet with me to discuss the potential law suit. I agreed

Affidavit of Frederic C. Dumaine, Jr.

and subsequently met with Mr. Hutchins, Mr. David W. Wallace, the present president of Punta, and two of Punta's attorneys, Mr. Ryan and Mr. Phillips.

(12) The next day Curtis Hutchins called again and asked if Mr. Ryan could meet with my lawyers at McGuire, Woods & Battle. I agreed, and I understand that Mr. Ryan did in fact travel to Charlottesville and meet with my lawyers there.

(13) I did not finally make the decision to institute this suit until after these meetings. I did not make this decision on the basis of personal animosity or ill-will but on the unanimous advice of all my lawyers that the suit had merit and should be brought.

(14) On a personal level I found bringing this suit disturbing, because of my personal relations down through the years with people involved with Punta, as set out in this affidavit above.

/s/ FREDERIC C. DUMAINE

Sworn to before me.
February 18, 1972

/s/ Illegible
Notary Public

My Commission Expires: 8/25/78

UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

NORTHERN DIVISION

BANGOR AND AROOSTOOK RAILROAD
COMPANY AND BANGOR INVESTMENT
COMPANY,

Plaintiffs,

v.

BANGOR PUNTA OPERATIONS, INC. AND
BANGOR PUNTA CORPORATION,

Defendants.

Civil Action,
Docket

No. 1933

MOTION RE: RECORD ON APPEAL

Now comes the Plaintiffs by their attorney, Howard H. Dana, Jr., Esquire, and move this Honorable Court as follows:

1. Attached to *Plaintiffs' Pre-Trial Memorandum* was a copy of the Report to the Commission—*Review of Diversified Holding Company Relationships and Transactions of Bangor Punta Corporation*, prepared by the Bureau of Accounts of the Interstate Commerce Commission. This Report was offered to indicate the public interest and concern involved in the treatment of the Plaintiffs by Defendants. This Report included the recommendation that, "(A)ll legal remedies be explored to require the holding company, which sold the carrier, to pay back to the carrier for assets taken with no compensation and charges made where no services were performed." *Report*, p. 2.

It also stated:

"While recognition is given to the adverse effect of such restitution on Punta's stockholders, and the

Motion Re: Record on Appeal

apparent gift to Amoskeag's stockholders, our primary concern is that carrier assets remain with the carrier for use in maintaining or improving its transportation service to the public."

Report, p. 9. The *Affidavit of Frederic C. Dumaine, Jr.* referred to this Report as having been a factor in this lawsuit being seriously considered. *Affidavit*, paragraph 8.

2. The decision of this Honorable Court which is appealed from states at page 5 in its decision:

"Nor do plaintiffs claim to bring this action . . . in the public interest."

3. Plaintiffs intend to stress in their appeal the public interest in this suit, as indicated by the Report.

4. Plaintiffs have been advised that absent an order by this Honorable Court, the Report will not be included in the "Record on Appeal." Rule 10, F.R.A.P.

WHEREFORE, Plaintiffs respectfully request that this Honorable Court declare that the Report, above referred to, be included in the official "Record on Appeal" to the Court of Appeals.

Dated this 14th day of February 1973.

/s/ HOWARD H. DANA, JR.
Counsel for Plaintiffs

VERRILL DANA PHILBRICK
PUTNAM & WILLIAMSON
57 Exchange Street
Portland, Maine 04111
207-774-4573

No. 73-1059.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BANGOR AND AROOSTOOK RAILROAD COMPANY, ET AL.,
Plaintiffs, Appellants,

v.

BANGOR PUNTA OPERATIONS, INC., ET AL.,
Defendants, Appellees.

MEMORANDUM AND ORDER

Entered March 26, 1973

The appellant's motion pursuant to Fed.R.App.P. 10(c) to supplement the record on appeal by inclusion of a Report by the Interstate Commerce Commission relating to the appellees and the events involved in this suit is denied without prejudice to the appellant's right to argue that the existence of the Report and its indication that there is a public interest in the rectification of the alleged wrongdoing is judicially noticeable.

By the Court:

/s/ DANA H. GALLUP
Clerk.

[Cert. cc: Clerk, U.S.D.C., Maine; cc: Messrs. Robinson, Putnam, Ryan, and Sawyer.]

August 3, 1973, First Circuit Opinion
UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 73-1059

BANGOR AND AROOSTOOK RAILROAD COMPANY, ET AL.,
Plaintiffs, Appellants,
v.

BANGOR PUNTA OPERATIONS, INC., ET AL.,
Defendants, Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MAINE

Before COFFIN, Chief Judge,
McENTEE and CAMPBELL, Circuit Judges.

Edward T. Robinson and Alan L. Lefkowitz, with whom Ely, Bartlett, Brown & Proctor, Roger A. Putnam, Howard H. Dana, Jr., and Verrill, Dana, Philbrick, Putnam & Williamson were on brief, for appellants.

James V. Ryan, with whom C. Kenneth Shank, Jr., Bruce Topman, Webster, Sheffield, Fleischmann, Hitchcock & Brookfield, Sumner T. Bernstein, Herbert H. Sawyer, and Bernstein, Shur, Sawyer & Nelson were on brief, for appellees.

August 3, 1973

CAMPBELL, Circuit Judge. A Maine railroad corporation and its wholly-owned subsidiary bring this action

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against their former owners, seeking damages under the federal anti-trust and securities laws, and under state law, for the alleged "looting" of the railroad in 1960-67 when the defendants were in control. Over 99% of its stock was purchased from the old owners after the alleged wrongs. The district court granted defendants' motion for summary judgment, holding that the railroad could not maintain what it termed "typical stockholder claims seeking an accounting for alleged misappropriation and waste of corporate assets by controlling stockholders" since the present owner was not a stockholder at the time of the alleged improper transactions and was not injured thereby. 353 F. Supp. 724, 728 (D. Me. 1972).

Plaintiff, Bangor and Aroostock Railroad Company (BAR),¹ operates a railroad in northern Maine. Plaintiff, Bangor Investment Company (BIC), a Maine corporation, is a wholly-owned subsidiary of BAR. Defendant, Bangor Punta corporation (Bangor Punta), a Delaware corporation the stock of which is listed upon the New York Stock Exchange, is a diversified holding company. Defendant, Bangor Punta Operations, Inc. (BPO), a New York Corporation, is a wholly-owned subsidiary of Bangor Punta.

Bangor Punta, in 1964, through its subsidiary BPO, acquired 98.3% of the stock of BAR, by acquiring all the

¹ It is alleged in the complaint that BAR "is a Maine Corporation organized in 1891 for the purpose of constructing, maintaining and operating a railroad for public use, and has its principal place of business in Bangor, Maine. It operates a railroad providing essential services for those persons and businesses located in the northern part of the State of Maine. BAR connects within the State of Maine with other railroads which serve the northeastern part of the United States, and which, in turn, connect with other railroads serving the remainder of the United States. Freight shipments of BAR consist of products grown and manufactured in the State of Maine, including potatoes, pulp and paper products, which are sold and used in other parts of the United States."

August 3, 1973, First Circuit Opinion

assets of Bangor and Aroostock Corporation (BAC), a Maine holding company established by BAR in 1960. Bangor Punta, through BPO, continued to own 98.3% of BAR's outstanding stock until October 2, 1969, at which time, for \$5,000,000, it sold its stock interest in BAR to Amoskeag Company (Amoskeag), a Delaware investment corporation controlled by Frederick C. Dumaine, Jr. Amoskeag later bought additional BAR shares, and now owns over 99% of all the outstanding stock of BAR.

The complaint contains thirteen counts. Damages totaling \$7,000,000, for BAR only, are sought on grounds of mismanagement, misappropriation and waste of corporate assets caused by four intercompany transactions taking place among BAC, Bangor Punta, BAR and BIC during the years 1960-67, while BAC and then Bangor Punta were in control of BAR and BIC. The defendants are said to have violated § 10 of the Clayton Act, 15 U.S.C. § 20, and § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder. They are also alleged to have violated the Maine common law and Section 104 of the Maine Public Utilities Act, 35 M.R.S.A. § 104.

The wrongful acts allegedly included overcharge by BAC and BPO for services to BAR; causing BAR to excuse BAC and BPO from interest payments due on loans and to pay improper dividends; the improper acquisition of St. Croix Paper Company stock owned by BAR through BIC; and causing BIC to engage in improper borrowings. In essence, defendants are alleged to have "dominated and controlled BAR and exploited it solely for their own purposes, to the injury of BAR and without regard to BAR's future obligations both to its creditors and to the public which it serves. By such domination, control and exploitation, [defendants] calcula-

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tedly drained the resources of BAR in violation of law for their own benefit. . . ."

The defendants moved for summary judgment "dismissing the entire complaint, as amended herein, with prejudice, for the reason that the complaint fails to state a cause of action on behalf of the corporate Plaintiffs; or in the alternative . . . dismissing each of Count II and Count V [brought under the Maine Public Utilities Act] of the amended complaint herein, with prejudice, for the reason that each of them fails to state a cause of action."

The district court granted defendants' motion, stating,

"Defendants seek dismissal of the entire complaint on the ground that Amoskeag, which would be the sole beneficiary of any recovery by the corporate plaintiffs, was not a stockholder of BAR at the time of the alleged improper transactions and itself sustained no injury as a result thereof. The Court agrees. Since the Court therefore concludes that the entire complaint must be dismissed, it does not reach defendants' alternative motion for dismissal of Counts II and V." 353 F. Supp. at 726.

Starting with the proposition that F.R.C.P. 23.1, the so-called contemporaneous ownership rule, would apply to a shareholder's derivative action brought to enforce the claims asserted here, the district court reasoned that Amoskeag, by causing the plaintiff corporations (essentially BAR) to bring this action, was attempting to accomplish indirectly what it could not do directly; namely, to bring "typical stockholder claims" for misappropriation and waste. Since Amoskeag,

"which did not itself incur any damage as a result of defendants' wrongful acts, and not the corporate plaintiffs, is the real beneficiary of any recovery

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which might be had in the name of the corporate plaintiffs, the corporate claims must fail for lack of equity on the part of those who would ultimately benefit from any corporate recovery." 353 F. Supp. at 728.

The district court relied on Commissioner Roscoe Pound's opinion in *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 661-62, 93 N.W. 1024, 1030-31 (1903), and like cases. See, e.g., *Capitol Wine & Spirit Corp. v. Pokrass*, 277 App. Div. 184, 98 N.Y.S.2d 291, *aff'd*, 302 N.Y. 734, 98 N.E.2d 704 (1951); *Amen v. Black*, 234 F.2d 12, 23 (10th Cir. 1956). *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 A. 645 (1917). *Home Fire* and its successors hold that a person who was not a stockholder at the time of the alleged mismanagement of a corporation may not later sue derivatively, nor, if he becomes the sole stockholder, may he cause the corporation itself to sue. Central to the conclusion that even the corporation may not sue is the assumption that "the shareholders . . . are the real and substantial beneficiaries of a recovery." *Home Fire Ins. Co. v. Barber*, *supra*, 67 Neb. at 664, 93 N.W. at 1031. Equity, "penetrating all fictions and disguises", treats the corporation as the alter ego of its stockholders: because it would be unjust to enrich them, the corporation may not be enriched. A corollary is that the corporation is barred from suing only if recovery would inure solely to the benefit of the estopped stockholders. If other eligible interests, such as creditors or minority shareholders, would benefit, the corporation may sue; since recovery is for the corporation the estopped stockholders would also benefit, but that is "an injustice which might be necessary to be suffered. . . ." *Capitol Wine & Spirit Corp. v. Pokrass*, *supra*, 98 N.Y.S.2d at 293.

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The *Home Fire* rule prevents a purchaser of all or most of the corporate stock, who probably purchased it at a price tied to the value of the assets at the time of sale, from recovering a windfall. Where maintenance of the corporate cause of action serves no other interest, such a result seems reasonable—although we leave open whether the equities reflected in *Home Fire* should be permitted to prevent suits under laws, such as the federal anti-trust and securities acts, that were enacted to protect interests other than, or in addition to, those of the current stockholders. Cf. *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 139 (1968).

Our difficulty here, however, is more fundamental. Even accepting *Home Fire*, we doubt its applicability. We reject the premise—critical both to the district court's holding and to the *Home Fire* rationale—that BAR's chief stockholder, Amoskeag, would be the "sole beneficiary" of a recovery for BAR. The premise, applied to a rail carrier, seems to us to be an over-simplification, although, without doubt, BAR's recovery would be highly beneficial to Amoskeag. Because of the nature of their services and of regulatory restrictions affecting them, and, more generally, because of their legal status as "quasi-public corporations", railroads cannot realistically be described as mere alter egos of their chief stockholders. If BAR's management complies with the law, recovery of monies by BAR may be expected not only to benefit its stockholders but to improve the economic position of the carrier, enabling it to enhance its services and helping stave off the financial crisis faced today by so many railroads. The net result will be of likely benefit to the public. Such considerations might be irrelevant in cases involving ordinary, closely held businesses; their survival is not usually deemed to be of public concern and they are typically

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viewed as mere projections of their stockholders. But courts — even before passage of extensive regulatory laws — have for years held that the public has an identifiable interest in a railroad corporation and in its ability — including its financial ability — to provide services and, indeed, to survive.

The public's interest, unlike the private interest of stockholder or creditor, is not easily defined or quantified, yet it is real and cannot, we think, be overlooked in determining whether the corporation, suing in its own right, should be estopped by equitable defenses pertaining only to its controlling stockholder. Here we think the public's interest in the financial health of BAR provides a separate interest, quite apart from Amoskeag's, which is served by the corporate cause of action.² Thus, regardless of

² Under the view we take of the case, we need not consider the district court's conclusion that the present suit is not being maintained in any meaningful way on behalf of the less than 1% of stock not owned by Amoskeag.

Nor do we analyze the extent to which the contemporaneous stock ownership rule is mandated, in a non-derivative action, by F.R.C.P. 23.1. Whether a stockholder is equitably barred from suit because he did not own the stock at the time of the alleged wrong or because he acquired it from wrongdoers is significant here only if we accept the district court's premise—as we do not—that BAR's controlling stockholder is the sole beneficiary of the instant litigation.

It can be argued, of course, that F.R.C.P. 23.1, dealing with derivative suits, does not establish a federal rule of contemporaneous ownership with respect to non-derivative proceedings. The underlying policies for adoption of the Rule—preventing transfer of a few shares to a non-resident to acquire diversity jurisdiction and to discourage strike suits—relate to abuses associated with minority stockholder proceedings. See *Hawes v. Oakland*, 104 U.S. 450 (1882); 3B Moore's Federal Practice, ¶ 23.1.15. The Maine Supreme Judicial Court has recently indicated willingness to relax the contemporaneous ownership requirement where fairness and sound policy warrant. See *Forbes v. Wells Beach Casin, Inc., et al.*, Docket No. 930, Law Docket No. 1688, June 28, 1973.

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the latter's motivations or potential receipt of undeserved benefits, BAR should be permitted, and indeed has a duty, to recover for itself any assets which were divested from it in violation of state or federal law.

A railroad is a "public" or "quasi-public" corporation. *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290, 321-22, 332-33 (1897); *Railroad Com'rs v. Portland and O.C.R.R.*, 63 Me. 269, 18 Am. Rep. 208 (1872); for a recent state case reaffirming the traditional concept, see *Louisville and Nashville Ry. v. Sutton*, 436 S.W.2d 487, 490 (Ky. Ct. App. 1969); see generally 1 Fletcher Cycl. Corps., § 63 (1963). According to the Maine Supreme Judicial Court,

"Railroad charters are contracts made by the legislature in behalf of every person interested in anything to be done under them." *Railroad Com'rs v. Portland and O.C.R.R.*, *supra*, 63 Me. at 278.

The provision of roads and "other artificial structures" for travel is a duty of government recognized from earliest times. *Id.* at 275. The granting of a franchise to operate a railroad was seen by the Maine court as a farming-out by government of a duty owed to the public.

"The fare is the consideration for the service performed, whether done by the State directly, or by a corporation under a grant from the State; it is simply a substitute for the tax rendered necessary when the State builds and conducts railroads at the public expense; the corporation, upon the payment of the fare, is under the same obligation to render the required service for the public, that the State would be, if railroads were free, and conducted by State authority. Nor does the ownership of railroads, whether it be

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in the State or a private corporation, affect the nature of their use, since in either case the function to be exercised and the uses to be subserved are public." *Id.* at 275-76.

It can, of course, be argued that all manner of businesses are affected with a public interest. See *Munn v. Illinois*, 94 U.S. 113 (1877) (regulation of private grain elevators). However that may be, railroads, involving the use and often the forced taking of interests in land³ and providing essential transportation, have acquired a unique status in our law; they were said by the Maine court in *Railroad Com'rs v. Portland and O.C.R.R.*, *supra*, 275, to be "pre-eminent" among private instrumentalities affected with a public interest. While the development of other modes of transportation has eroded this "preeminence", the Maine courts have not modified their view of the unique legal status of railroad companies, which are also regulated "public utilities" under Maine law, 35 M.R.S.A. § 15.13 *et seq.*

Federal courts, including the Supreme Court, early took the same view of the public or quasi-public character of railroads. In *United States v. Trans-Missouri Freight Ass'n*, *supra*, 166 U.S. at 332-33, the Supreme Court said,

"... railways are public corporations organized for public purposes, granted valuable franchises and privileges, among which the right to take the private property of the citizen *in invitum* is not the least, ... many of them are donees of large tracts of public

³ Beginning in 1850, Congress lavishly subsidized railroad construction by land grants: for example, an estimated 40,000,000 acres was granted to the Northern Pacific, *Great Northern Ry. v. United States*, 315 U.S. 262, 276 (1942). Under Maine law, land may be taken for railroad purposes by eminent domain. 35 M.R.S.A. § 651 *et seq.*

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lands and of gifts of money by municipal corporations, and . . . they all primarily owe duties to the public of a higher nature even than that of earning large dividends for their shareholders. The business which the railroads do is of a public nature, closely affecting almost all classes in the community"

More recently, the public importance of the rail carriers has been recognized in context of the economic crisis threatening their continued existence. Indeed, since the temporary nationalization of the railroads in World War I, the preservation of the railroads has been a national concern. Interpreting the Transportation Act, 1920, Mr. Justice Brandeis said,

"By that measure, Congress undertook to develop and maintain, for the people of the United States, an adequate railway system. It recognized that preservation of the earning capacity, and conservation of the financial resources, of individual carriers is a matter of national concern; . . ." *Texas & Pac. Ry. v. Gulf, etc. Ry.*, 270 U.S. 266, 277 (1926).

In 1933, Congress added Section 77 to Chapter VIII of the Bankruptcy Act, providing for the financial reorganization of ailing railroads. A policy of Section 77 is "that the operation of railroads as sound, economic units should be achieved for the benefit of the public, regardless of the interests of creditors and stockholders." 5 Collier on Bankruptcy, 14th ed., ¶ 77.02. p. 469. In *Reconstruction Finance Corp. v. Denver & R.G.W.R.R.*, 328 U.S. 495, 536 (1946), the Court said, "[B]y their entry into a railroad enterprise, [security holders] assumed the risk that in any depression or any reorganization the interests of the public would be considered as well as theirs." See *New Haven Inclusion Cases*, 399 U.S. 392, 492 (1970). Cf. Note,

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Takings and the Public Interest in Railroad Reorganization, 82 Yale L.J. 1004 (1973). Worry over the public effect of the Northeastern railroads' insolvency appears in the Interstate Commerce Commission's *Northeastern Railroad Order of Investigation* (Ex Parte No. 293, Feb. 7, 1973, 38 Fed. Reg. 6253 (1973)), noting the entry into Section 77 reorganization of seven Class I railroads, and the danger that acute cash crises of several might lead to the eventual cessation and liquidation of the transport facilities of the carriers. The I.C.C. found these matters to "create implications of nationwide importance." Similar concern resulting from the Penn Central financial crises was expressed in Senate Joint Resolution 59 approved Feb. 9, 1973 (P.L. 93-5, 87 Stat. 5, 1973 U.S. Code Cong. & Ad. News 379).

In 1960 the Maine Supreme Judicial Court concluded that local freight lines (BAR is one such) were crucially important to the Maine economy. The court said, in *Maine Cent. R.R. v. Public Utilities Comm'n*, 156 Me. 284, 163 A.2d 633, 637 (1960):

"There can be no question as to the very real need which the whole public of Maine has for an efficient freight service by rail. There are many raw materials and products of great weight and bulk which can only be carried efficiently in and out of Maine in freight cars. This state is somewhat remote from the principal markets and thus dependent on fast and economical transportation of goods. We are engaged in spirited competition with our sister states for new industry which will add to payrolls and taxes and assure the economic health of Maine. Moreover, existing established industry must be encouraged and preserved and agriculture must not be deprived of indispensable freight service. Here we are dealing with

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the *public interest* in its broad sense for every citizen of Maine has a stake in the industrial and economic vitality of his state."

Given today's circumstances of which we are all generally aware, and the legal history above cited, it would be unrealistic to treat a railroad's attempt to secure the reparation of misappropriated assets as of concern only to its controlling stockholder. To do so grants to the defendants an undeserved immunity from suit, to the disadvantage of the public, solely to avoid a windfall to Amoskeag which, whatever its own lack of equity, is neither a wrongdoer nor a participant in any wrong. We see BAR and its management as seeking a corporate recovery in which the public has a real, if inchoate interest. Amoskeag's windfall is irrelevant to that interest, and should not be the factor which determines whether or not BAR may sue.

Moreover, to prevent BAR from suing to recover assets wrongfully divested is to reject the use of private litigation as a deterrent to patently undesirable conduct. The management of a rail carrier — whoever it may be and whatever its private aims — is best situated to learn of wrongs to the railroad and to take effective action to redress them. The looting of a railroad and its possible decline or even failure are so clearly violative of state and federal policies, as expressed both in legislation and in the decisions of courts, as to invite the encouragement of private lawsuits as a supplement to public enforcement. See *J. I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964); *Perma Life Mufflers, Inc. v. International Parts Corp.*, *supra*, 392 U.S. at 139. The private financial incentive for those bringing the action helps assure that it will be brought; federal and state agencies, sometimes hampered by inadequate funding or diverted by other concerns, may not be able to take the necessary action.

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Thus we hold that neither the federal nor the state counts are foreclosed by the failure of BAR's principal stockholder to own its stock during the period of the wrongful conduct nor by Amoskeag's purchase of the stock from the alleged wrongdoers.

We are left with a final major question which we do not now attempt to resolve; namely, the extent, if any, to which the district court should try to insure that recovery, if any, does not benefit Amoskeag at the expense of the railroad and the public which it serves. If BAR should recover, Amoskeag's BAR stock will increase in value. An increase in stock value is a windfall which can hardly be avoided; it would not be inconsistent with the public's interest in a healthier railroad. On the other hand, a syphoning off of BAR's recovery into the pockets of present stockholders or others would be different. Hopefully, the very logic by which appellants are allowed to sue here may help to deter at least illegal distributions. In any event, we have no doubt of the power of the district court, in conjunction with any recovery, to enter orders, if appropriate, prohibiting distributions by BAR that would conflict with state or federal law. A more difficult question arises with respect to its ability to enter more sweeping prohibitions to ensure that BAR's recovery is not unreasonably diverted for the private enrichment of its stockholders.

If plaintiffs prevail, the latter is a matter which the parties and the district court may consider further, possibly with the invited assistance of state and federal agencies. Our ruling that the plaintiffs may sue is not conditioned on the devising of court-imposed limitations on the uses of any corporate recovery. Even without limitations, the public interest is better served than were civil immunity to be assured to those who may have

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syphoned funds from a rail carrier in violation of State and federal law. Whether a court could properly or practicably regulate (beyond existing state and federal law) the use which a carrier might make of any recovered funds, we are not prepared to decide at this time.

We understand the district court's order for summary judgment to be based solely on its determination that plaintiffs were barred from suing because of Amoskeag's failure to own stock at the time of the alleged wrongs and its purchasing of stock from alleged wrongdoers. Our decision reverses that determination; it leaves all other issues open, including the merits of plaintiffs' claims, which have yet to be tried. The district court not having ruled thereon, we express no opinion on defendants' motion, on different grounds, to dismiss Counts II and V.

Reversed and remanded for proceedings consistent herewith.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 73-1059.

BANGOR AND AROOSTOOK RAILROAD COMPANY, ET AL.,
Plaintiffs, Appellants,
v.

BANGOR PUNTA OPERATIONS, INC., ET AL.,
Defendants, Appellees.

JUDGMENT

Entered: August 3, 1973

This cause came on to be heard on appeal from the United States District Court for the District of Maine, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The order of the district court is vacated, and the cause is remanded to that court for further proceedings consistent with the opinion filed today. No costs at this time.

By the Court:

/s/ DANA H. GALLUP
Clerk.

[cc: Messrs. Robinson and Ryan.]

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Supreme Court of the United States

No. 73-718

Bangor Punta Operations, Inc., et al.,

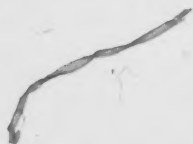
Petitioners,

v.

Bangor & Aroostook Railroad Company, et al.

ORDER ALLOWING CERTIORARI. Filed January 7 , 1974.

The petition herein for a writ of certiorari to the United States Court of Appeals for the First ----- Circuit is granted.



No. 73-_____

FILED

OCT 31 1973

73-718

MICHAEL RODAK, JR., CL

IN THE

Supreme Court of the United States

October Term, 1973

**BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,**
Petitioners,

v.

**BANGOR & AROOSTOOK RAILROAD COMPANY
and BANGOR INVESTMENT COMPANY,**
Respondents.

**PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT**

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October 31, 1973

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IN THE
Supreme Court of the United States
October Term, 1973

No. 73-_____

BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,
Petitioners,

v.

BANGOR & AROOSTOOK RAILROAD COMPANY
and BANGOR INVESTMENT COMPANY,
Respondents.

**PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT**

Petitioners, Bangor Punta Operations, Inc. and Bangor Punta Corporation, Defendants-Appellees below, pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the First Circuit which was entered on August 3, 1973.

Opinions Below

The opinion of the District Court for the District of Maine is reported at 353 F. Supp. 724 (D. Me. 1972) and is reproduced at pp. 1a-12a of the Appendix hereto (App.). The opinion of the Court of Appeals (App. pp. 13a-26a) has not yet been officially reported.

Jurisdiction

The decision of the First Circuit, reversing the decision of the District Court, was entered on August 3, 1973. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254 (1).

Questions Presented

(1) Whether, notwithstanding this Court's decision in *Sierra Club v. Morton*, 405 U.S. 727 (1972), the Court of Appeals for the First Circuit can allow a party, which has itself suffered no injury, to maintain an action for the benefit of the general public.

(2) Whether the fact that a corporation is a railroad suspends the applicable rules with respect to standing so as to permit actions by the general public for alleged violations of the securities and antitrust laws and for corporate waste and mismanagement.

(3) Whether the contemporaneous share ownership requirement embodied in Rule 23.1 of the Federal Rules of Civil Procedure should be abandoned with respect to actions involving corporations whose business affects the public welfare.

Statutes and Regulations Involved

The following statutes and regulations are involved: Clayton Act § 10, 15 U.S.C. § 20; Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b); SEC Rule 10b-5, 17 C.F.R. § 240.10b-5; and Rule 23.1 of the Federal Rules of Civil Procedure. The text of pertinent parts of the statutes and regulations are set forth at pp. 27a to 29a in the Appendix hereto.

Statement of the Case

This is an action brought nominally by the Bangor and Aroostook Railroad Corporation (BAR) and its wholly-

owned subsidiary, Bangor Investment Company (BIC), against BAR's former owners, Bangor Punta Operations, Inc. (BPO) and Bangor Punta Corporation (Bangor Punta). Plaintiffs allege mismanagement, misappropriation, and waste of corporate assets during the period defendants owned 98.3% of the outstanding capital stock of BAR. Plaintiffs also allege that certain of these transactions violated Section 10 of the Clayton Act (15 U.S.C. § 20), Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and Rule 10b-5 thereunder, the Maine Public Utilities Act, and the common law of Maine.

While BAR and BIC are the named plaintiffs, the real plaintiff and party in interest is The Amoskeag Company ("Amoskeag"), a Delaware investment company which owns virtually all of BAR's outstanding common stock. On October 2, 1969, Amoskeag purchased the defendants' 98.3% interest in BAR for approximately \$5,000,000, and since that date has increased its holdings to approximately 99.3%. Since October 1, 1969, Amoskeag has exercised the effective control and management of BAR.

On September 14, 1972, defendants moved for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. By order dated December 29, 1972, the United States District Court for the District of Maine (Edward T. Gignoux, D.J.) awarded defendants summary judgment and dismissed the action on the ground that, from the undisputed facts of the case, plaintiffs were precluded by well established equitable principles from maintaining the action.

The District Court's opinion emphasized three crucial and uncontested facts: 1) the real plaintiff and party in interest and beneficiary of any recovery was Amoskeag, the 99% owner of the corporate plaintiffs; 2) Amoskeag, which purchased its BAR stock in October, 1969, was not a shareholder at the time the alleged wrongs to the corporate plaintiffs occurred; and 3) Amoskeag made no claim that

it was deceived nor that it received anything but full value when it bought its BAR stock (App. pp. 3a-4a).

On the basis of these undisputed facts, the District Court found that Amoskeag had sustained no injury, direct or indirect, and held that the suit which it had caused to be brought by the corporate plaintiffs was in reality a suit by a stock purchaser who had received fair value, seeking to recover back its purchase price (plus an additional windfall of \$2,000,000), while at the same time retaining the stock. (App. pp. 4a, 7a) The Court refused to permit Amoskeag to so use the corporation to enrich itself unjustly, and dismissed the suit.

On August 3, 1973, the United States Court of Appeals for the First Circuit reversed the District Court's decision. The Court of Appeals did not reject the continuing validity of the principles applied by the District Court in dismissing BAR's claim and, in fact, recognized that Amoskeag was totally lacking in equity. (App. p. 24a) The Court nonetheless reversed the District Court on the theory that BAR, the nominal plaintiff, was a railroad, and "the public's interest in the financial health of BAR provides a separate interest, quite apart from Amoskeag's, which is served by the corporate cause of action." (App. p. 19a) This "separate interest" of the public, the Court held, was the basis for allowing Amoskeag, through the instrument of the corporate plaintiffs, to bring a suit which would otherwise be barred. The Court stated its view as follows:

"We see BAR and its management as seeking a corporate recovery in which the public has a real, if inchoate interest. Amoskeag's windfall is irrelevant to that interest, and should not be the factor which determines whether or not BAR may sue." (App. p. 24a)

Although the Court of Appeals held that the presumed public benefit was the sole basis for permitting the suit to be maintained, it admitted that the public would probably

not share, in any recovery by BAR. Specifically, the Court of Appeals conceded that there was a great danger that any recovery by BAR would be syphoned off into the pockets of present stockholders, thus defeating "the very logic by which [BAR, BIC and Amoskeag] are allowed to sue here." (App. p. 25a)

With respect to that possibility, the Court could only suggest that the District Court might attempt to enter some type of order preventing a distribution. It conceded, however, that there was serious question whether the District Court even had the power to enter such an order or whether any "court could properly or practicably regulate . . . the use which a carrier might make of any recovered funds . . ." (App. pp. 25a-26a) In effect, the Court admitted that the public benefit upon which it had premised its decision was probably illusory.

Reasons for Granting the Writ

A. The Court of Appeals' decision herein conflicts with the principles enunciated by this Court in *Sierra Club v. Morton*, 405 U.S. 251 (1972), in that it permits a litigant that has itself suffered no injury to maintain an action on behalf of the general public.

It is indisputable that Amoskeag, the owner of over 99% of the stock of BAR, is the real plaintiff and party in interest bringing the instant action. It is also indisputable that Amoskeag, having purchased its BAR stock after the acts complained of and having received full value for its purchase price, has suffered no injury. The Court of Appeals explicitly held this lack of injury irrelevant, however, because of an assumed "separate interest" of the general public which it believed would be served by successful prosecution of the action and a recovery herein.

The Court of Appeals' disregard of the lack of injury to the real plaintiff and party in interest is in direct conflict with the rules governing standing recently laid down by this Court in *Data Processing Service v. Camp*, 397 U.S.

150 (1970) and *Sierra Club v. Morton*, 405 U.S. 727 (1972). In *Data Processing*, this Court stated with regard to standing that "the first question is whether plaintiff alleges that the challenged action has caused him injury in fact, economic or otherwise." 397 U.S. at 152. In *Sierra*, the Court applied this principle, affirming a lower court's decision dismissing the action on the ground that although the plaintiff alleged an injury to a cognizable interest, it did not meet the second element of the test: that the party "be himself among the injured." 405 U.S. at 735.

The *Sierra* case is directly applicable to the case at bar. As in *Sierra*, a party that has itself suffered no injury has caused an action to be brought. Also, as in *Sierra*, the lack of injury is sought to be remedied by allegations of injury to the general public, which general public the plaintiff seeks to represent. The Court's rejection of the Sierra Club's contention is determinative of Amoskeag's right here to sue based on an assumed championship of the public's interest.

Indeed, Amoskeag has even less claim to represent the public interest than did the Sierra Club. The Sierra Club could plausibly maintain that even if it had suffered no injury itself, its long standing commitment to the cause of conservation made it a proper representative of the public interest. Amoskeag, however, can make no such claim. As a registered investment company, its responsibility is to its shareholders, and its duty is to earn as much profit as possible from its investment in BAR. In such a posture, its interests are antagonistic to those of the public serviced by BAR, as the Court of Appeals recognized in its statement that Amoskeag might attempt to siphon off any recovery for its own benefit. (App. pp. 25a-26a) It is inconceivable that Amoskeag would be permitted to bring a class action on behalf of the people of Maine; *a fortiori*, it is an unsuitable party to vindicate their rights.

Beyond the issue of adequacy of representation, however, the crucial point is that the Court of Appeals' decision holds that a party concededly having suffered no injury may sue to vindicate a presumed public interest. The decision

thus directly conflicts with this Court's decisions in *Sierra v. Morton, supra* and *Data Processing v. Camp, supra*, and throws into question the continued validity of those decisions.

B. The Court of Appeals' decision radically enlarges the boundaries of actions under the antitrust and securities statutes and general corporate law by holding that damage actions which previously could be brought only by shareholders, purchasers and sellers, and direct targets of violations, may now be brought by and on behalf of the general public. If permitted to stand, the Court's decision will be precedent for a wave of individual and class actions heretofore barred.

As pointed out in the Statement of the Case, *supra*, the Court of Appeals agreed that Amoskeag's lack of equity would bar the action under the generally applicable principles, but nonetheless reversed the District Court because of its view that "the public's interest in the financial health of BAR provides a *separate interest*, quite apart from Amoskeag's which is served by the corporate cause of action" (App. p. 19a, emphasis added). The Court's holding was that this assumed public interest provided an independent basis for suit which could support the action.

The foregoing holding—that an assumed public interest in the financial health of a railroad provides an independent basis for maintenance of a private damage action—has far-reaching and revolutionary implications. The claims asserted in this action are for corporate waste and mismanagement, and for alleged violations of the antitrust and securities laws. Herefore, only shareholders, purchasers and sellers, or in the case of the antitrust laws, persons who were the direct targets of violations have been held to have an interest sufficient to provide the basis for a damage action asserting such claims. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2nd Cir. 1952), *cert. denied*, 343 U.S. 956 (1952); *Commonwealth Edison Co. v. Allis-Chalmers Mfg. Co.*, 315 F.2d 564 (7th Cir. 1963), *cert. denied sub nom.*

Illinois v. Commonwealth Edison Co., 375 U.S. 834 (1963). The Court of Appeals for the First Circuit now has recognized a new category of persons with such an interest—the general public—and held that a damage suit can be maintained on the public's behalf whenever there is an alleged injury to a private corporation whose business affects the public interest.

The reach of such a holding goes far beyond the instant case. In this action, the Court permitted Amoskeag to sue to champion the public's interest. In another case, the rationale that here permits Amoskeag to sue would require recognition of the right of the public to sue in its own behalf. For if the Court is correct that the public's inchoate and indirect interest is a legal interest upon which suit can be brought, that right cannot depend on the fortuity—present in this case—of the sale of a controlling interest to a new owner. If the interest exists, it must be capable of vindication even in the absence of transfers of stock to new owners and a willingness of those new owners to bring suit. A substantial right cannot depend for its vindication on a chance event and the whim of a stranger, particularly a stranger with interests antagonistic to the public.

The Court's holding thus makes three radical changes in present doctrine. First, it permits suits on behalf of parties at most only indirectly injured. Second, it permits suits by or on behalf of the widest possible group—the general public. Third, it permits suits on the basis of a presumed injury so vague and remote that the Court of Appeals itself described it as “inchoate” and the complaint failed to allege it. (App. p. 24a)

The effect of such a holding is clear. A new cause of action—a private damage action for indirect and inchoate injuries by and on behalf of the general public—has been recognized. Henceforth, so long as a corporation is engaged in a business affecting the public interest, any declaration by it of dividends, any transaction giving rise to

a possible claim under the securities laws, any action arguably in violation of antitrust laws—all may be challenged or sued upon by members of the general public. If permitted to stand, the decision cannot fail to be the forerunner of a wave of individual and class actions unprecedented in volume and scope.

No decision of this or any other court has sanctioned such a bold and radical expansion of standing to bring damage suits for violation of the securities and antitrust laws and corporate waste and mismanagement. It is respectfully submitted that if such a radical and far-reaching change is to be made, it should only be done after careful consideration by and decision of this Court.

C. The decision of the Court of Appeals throws into question the continued validity of the contemporaneous share ownership rule adopted by this Court and subsequently applied by all state and federal courts.

Over ninety years ago, in *Hawes v. Oakland*, 104 U.S. 450 (1882), this Court enunciated the contemporaneous share ownership rule that has since become the universal rule governing shareholder actions of the type presented in this action. This rule has been carried over into the present Federal Rules of Civil Procedure as Rule 23.1.

The sound equitable principle which led to the application of the contemporaneous share ownership rule in formal derivative suits was held equally applicable to suits nominally brought by a corporation itself in the landmark case of *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N.W. 1024 (1903). In that case, Dean (then Commissioner) Roscoe Pound held that courts must “look behind the corporation [bringing suit] to the shareholders, who are the real and substantial beneficiaries” of any recovery to the corporation “and ascertain whether these ultimate beneficiaries of the relief it is asked to grant have any standing to demand it.” (67 Neb. at 665, 93 N.W. at 1032). Accordingly, where a corporation is controlled by shareholders who were not shareholders at the time of any of the alleged

wrongs, the contemporaneous share ownership rule which barred the shareholders from bringing suit barred the corporation from suing as well.

Every court which has since been confronted with a case similar to the case at bar has dismissed the corporation's complaint on the grounds that the contemporaneous share ownership rule which barred the shareholder barred the corporation. In each case, the courts recognized the obvious fact that to permit recovery by the corporation would merely result in windfall profits to shareholders that had suffered no injury. *Amen v. Black*, 234 F. 2d 12 (10th Cir. 1956); *Park Terrace, Inc. v. Burge*, 249 N.C. 308, 106 S.E. 2d 478 (1959); *Mathews v. Fort Valley Cotton Mills*, 179 Ga. 580, 176 S.E. 505 (1934); *State Trust & Savings Bank v. Hermosa Land & Cattle Co.*, 30 N.M. 566, 240 P. 469 (1925); *Pueblo Foundry & Machine Co. v. Lannon*, 68 Colo. 131, 187 P. 1031 (1920); *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 A. 645 (1917); *First State Bank v. Morton*, 146 Ky. 287, 142 S.W. 694 (1912).

The decision of the District Court in the instant case thus followed a long line of established precedents. The Court of Appeals' decision, reversing the District Court, brushed aside these distinguished precedents, and enunciating a novel and heretofore unknown exception, viz.: that the rule is inapplicable whenever the nominal plaintiff is a corporation whose business affects the public interest. (App. pp. 18a-19a)

Not only has the exception created by the Court of Appeals never before been recognized; it has been implicitly rejected. In *Home Fire Ins. Co. v. Barber*, *supra*, the first case to give the rule extended consideration, Dean Pound applied the rule in a case where the nominal plaintiff was an insurance company. Similarly, in *First State Bank v. Morton*, *supra*, the rule was applied in an action where the nominal plaintiff was a bank. The fact that the nominal plaintiff is a corporation whose business affects the public welfare, or in whose economic health the public has an interest, has never been considered a valid basis for not applying the rule.

It is unnecessary to go beyond the instant case to understand why this is so. It is undisputed that any corporate recovery in this action will principally benefit Amoskeag, an uninjured shareholder. Yet that is precisely the result the contemporaneous share ownership rule was designed to prevent. The Court of Appeals' exception is inconsistent with the *raison d'être* of the rule.

The refusal of the First Circuit Court of Appeals to follow a well-settled rule and equitable principle which has stood for nearly 100 years is thus clearly erroneous as a matter of law. Moreover, it is an error with potentially grave and far-reaching consequences. The contemporaneous share ownership rule and underlying principle are embodied in Rule 23.1 and state statutes and decisions throughout the nation. The Court's decision throws into question the scope and continued validity of this widely applied and beneficial rule and principle, and opens the way to the abuse of the shareholder action and corporate form which the rule has heretofore thwarted.

Conclusion

For the foregoing reasons, a writ of certiorari should issue to review the order and opinion of the Court of Appeals for the First Circuit.

Respectfully submitted,

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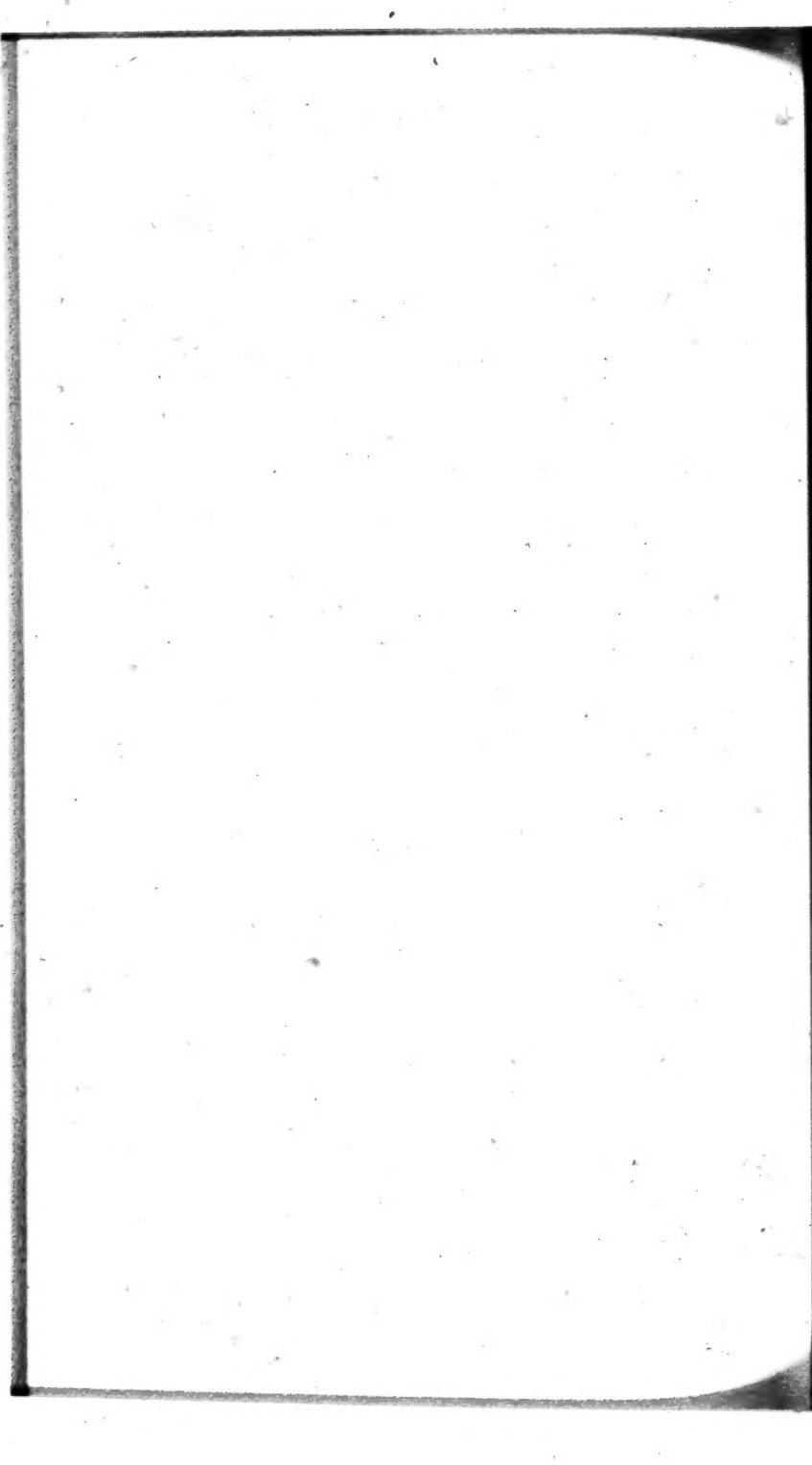
WEBSTER SHEFFIELD FLEISCHMANN

HITCHCOCK & BROOKFIELD

BERNSTEIN SHUB SAWYER & NELSON

October 31, 1973

APPENDIX



December 29, 1972, District Court Opinion

**BANGOR AND AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,**
Plaintiffs,
v.

**BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,**
Defendants.

Civ. No. 1933.

**UNITED STATES DISTRICT COURT
D. MAINE, N. D.
DECEMBER 29, 1972.**

OPINION AND ORDER OF THE COURT

GIGNOUX, District Judge.

This action arises under the Securities Exchange Act of 1934, the Clayton Antitrust Act, the Maine Public Utilities Act, and the common law of Maine. Plaintiff Bangor and Aroostook Railroad Company (BAR) is a Maine corporation which operates a railroad in the northern part of the State of Maine. Plaintiff Bangor Investment Company (BIC), a Maine corporation, is a wholly-owned subsidiary of BAR. Defendant Bangor Punta Corporation (Bangor Punta), a Delaware corporation, is a diversified holding company with operating units in various industries. Defendant Bangor Punta Operations, Inc. (BPO), a New York corporation, is a wholly-owned subsidiary of Bangor Punta. On October 13, 1964, Bangor Punta, through its wholly-owned subsidiary BPO, became the owner of approximately 98.3% of the stock of BAR when BPO acquired all the assets of Bangor and Aroostook Corporation (BAC), a Maine

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holding company which BAR had caused to be formed in 1960. From October 13, 1964 until October 2, 1969, Bangor Punta owned through BPO approximately 98.3% of all the outstanding stock of BAR. On October 2, 1969, BPO sold all its stock interest in BAR to Amoskeag Company (Amoskeag), a Delaware investment company controlled by Frederic C. Dumaine, Jr., for a consideration of approximately \$5,000,000. Subsequently, Amoskeag has purchased additional BAR shares, and now owns over 99% of all the outstanding capital stock of BAR.

The complaint contains thirteen counts and seeks damages totaling approximately \$7,000,000 for misappropriation and waste of corporate assets alleged to have been caused to BAR by four intercompany transactions, which allegedly took place between BAC or Bangor Punta and BAR during the period between 1960 and 1967, while BAC and then Bangor Punta were in control of BAR. Counts I and II are brought, respectively, under the common law of Maine (Count I) and Section 104 of the Maine Public Utilities Act (35 M.R.S.A. § 104) (Count II). They charge that BAC, and later BPO, improperly charged BAR for nominal legal, accounting, printing and other services furnished BAR by BAC and BPO. Counts III, IV, V and VI are brought, respectively, under the common law of Maine (Count III); Section 10 of the Clayton Antitrust Act (15 U.S.C. § 20) (Count IV); Section 104 of the Maine Public Utilities Act (Count V); and Section 10(b) of the Securities Exchange Act (15 U.S.C. § 78j(b)) and Rule 10b-5 (17 C.F.R. § 240.10b-5) promulgated thereunder by the Securities and Exchange Commission (Count VI). They are based upon the charge that BAC improperly acquired St. Croix Paper Company stock owned by BAR through its wholly-owned subsidiary BIC. Counts VII, VIII, IX and X are brought, respectively, under the common law of Maine (Counts VII and IX); and Section 10(b) of the Securities

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Exchange Act and Rule 10b-5 thereunder (Counts VIII and X). They charge that BAC and BPO improperly caused BAR to declare special dividends to its stockholders, including BAC and BPO, and improperly caused BIC to borrow so as to satisfy certain balance sheet ratios required by an earlier loan agreement in order to pay a regular dividend. Counts XI, XII and XIII are brought, respectively, under the common law of Maine (Count XI); Section 10 of the Clayton Antitrust Act (Count XII); and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder (Count XIII). They allege that BAC improperly caused BAR to excuse payment by BAC and BPO of the interest due on a loan made by BAR to BAC. In substance, the complaint alleges that Bangor Punta and its predecessor in interest, BAC, while they were in control of BAR through ownership of 98.3% of its stock, "calculatedly" drained the resources of BAR in violation of law for their own benefit" during the period between 1960 and 1967, prior to the time Amoskeag purchased Bangor Punta's interest in BAR.

Presently before the Court is defendants' motion for summary judgment dismissing the entire complaint, or in the alternative dismissing the two counts brought under the Maine Public Utilities Act (Counts II and V). Defendants seek dismissal of the entire complaint on the ground that Amoskeag, which would be the sole beneficiary of any recovery by the corporate plaintiffs, was not a stockholder of BAR at the time of the alleged improper transactions and itself has sustained no injury as a result thereof. The Court agrees. Since the Court therefore concludes that the entire complaint must be dismissed, it does not reach defendants' alternative motion for dismissal of Counts II and V.

It is true that, as plaintiffs assert, the present action is an action brought by the corporate plaintiffs in their own

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right, and does not purport to be a derivative action on behalf of either Amoskeag or the 1% minority stockholders in BAR. But, looking at the substance of the action, it is evident that the real party in interest is Amoskeag, the present owner of over 99% of the outstanding BAR shares. And having purchased the stock of BAR from Bangor Punta in 1969, long after the events complained of occurred, Amoskeag is clearly attempting, by having the corporations which it controls bring the action in their names, to recover the full \$5,000,000 consideration paid to Bangor Punta for the BAR shares, plus \$2,000,000 more, while still keeping the BAR shares. Amoskeag does not claim that it was deceived or defrauded by Bangor Punta when it purchased its BAR stock, or that it did not get full value for its purchase price. Nor do plaintiffs claim to bring this action on behalf of any creditors or in the public interest. It would accordingly be contrary to settled equitable principles to permit Amoskeag, by thus using the corporate fiction, to acquire a windfall for any past misbehavior on the part of Bangor Punta during the period when Amoskeag had no interest in BAR and sustained no injury, direct or indirect, as a result of Bangor Punta's alleged improper acts.

Plaintiffs admit that the alleged wrongs took place before Amoskeag purchased its BAR stock from Bangor Punta. Under these circumstances, there can be little doubt that Amoskeag would be barred from maintaining a derivative suit on behalf of BAR for the wrongs alleged to have occurred before Amoskeag purchased its BAR shares. As to the claims asserted under the Securities Exchange Act and the Clayton Antitrust Act, Fed.R.Civ.P.23.1 would apply and in terms requires contemporaneous ownership for maintenance of a stockholder derivative action. *Surowitz v. Hilton Hotels Corp.*, 342 F. 2d 596, 604 (7th Cir.

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1965); *Gottesman v. General Motors Corp.*, 28 F.R.D. 325 (S.D.N.Y.1961). To the extent that plaintiffs' claims arise under state law, jurisdiction being based upon diversity of citizenship, there is doubt as to whether the federal rule or state law applies. See 3B Moore's Federal Practice (2d ed. 1969) ¶ 23.1.15[2]. The majority of states, however, also have adopted the contemporaneous ownership rule, either by judicial decision or by statute. *Id.* at note 6. And even in those cases where the rule has not been applied, it has been held that a subsequent shareholder cannot sue where, as in the present case, he acquired his stock from the alleged wrongdoer, who himself would have been barred by his participation and acquiescence.¹ See, e. g., *Bloodworth v. Bloodworth*, 225 Ga. 379, 387, 169 S.E.2d 150, 156-157 (1969); *Babcock v. Farwell*, 245 Ill. 14, 40-41, 91 N.E. 683, 692-693 (1910); *Home Fire Insurance Co. v. Barber*, 67 Neb. 644, 661-662, 93 N.W. 1024, 1030-1031 (1903); *Bookman v. R. J. Reynolds Tobacco Co.*, 138 N.J.Eq. 312, 372, 48 A.2d 646, 680 (Ch.1946). Plaintiffs instituted the present suit two days prior to the effective date of the new Maine Business Corporation Act, which adopts the contemporaneous ownership rule, 13-A M.R.S.A. § 627(1)(A) (1972). It is an open question in Maine whether the contemporaneous ownership rule applied at the time the present suit was brought. See Field, McKusick & Wroth, Maine

1. Plaintiffs allege no facts which would support the allegation in their complaint that "[t]he injury to BAR is a continuing one surviving the aforesaid sale [from BPO] to Amoskeag." There is thus no basis for any suggestion that they may rely upon the "continuing wrong" exception to the contemporaneous ownership rule, which permits a subsequent stockholder to maintain a derivative suit if the alleged wrongful acts and their effects continue and are injurious to to him. Moreover, there is serious question as to whether such an exception should be recognized at all. Compare *Duncan v. National Tea Co.*, 14 Ill.App.2d 280, 144 N.E.2d 771, 775 (1957) with *Weinhaus v. Gale*, 237 F.2d 197, 199-200 (7th Cir. 1956); *Bowman v. Alaska Airlines*, 14 Alaska 62, 14 F.R.D. 70, 72 (1952).

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Civil Practice (2d ed. 1970) § 23.2 at 393.² But there is no indication in the Maine cases that the Maine court would not have followed the prevailing rule. In such situations, where the law of the particular state is not shown to be in conflict with the federal rule, federal courts will apply Rule 23.1. *Gallup v. Caldwell*, 120 F.2d 90, 94-95 (3rd Cir. 1941); *Mullins v. DeSoto Securities Co.*, 45 F.Supp. 871, 878 (W.D.La.1942); see 3B Moore's Federal Practice, ¶ 23.1-15[2] at n. 13. Thus, whether the federal rule or Maine law is applicable, Amoskeag could not maintain a derivative action against the defendants.

From the foregoing, it is evident that Amoskeag, by causing the plaintiff corporations to bring this action, is attempting to accomplish indirectly what it could not do directly. Plaintiffs contend that the Court cannot look beyond the corporate form to the substance of the corporate claims and the true beneficiary thereof. But the four inter-company transactions that are the basis of plaintiffs' claims are typical stockholder claims seeking an accounting for alleged misappropriation and waste of corporate assets by controlling stockholders. Equitable considerations must be applied in such actions. *Amen v. Black*, 234 F.2d 12 (10th Cir. 1956); *Matthews v. Headley Chocolate Co.*, 130 Md. 523,

2. Defendants point to *Hyams v. Old Dominion Co.*, 113 Me. 294, 93 A. 747 (1915) as indicating the new Maine Business Corporation Act merely codified pre-existing Maine law. In that case, the defendant objected that the plaintiff could not complain because the wrong, if any, was done before he became a stockholder. The court said: "One answer to this, and a sufficient one, is that the wrong is a continuing one." 113 Me. at 302, 93 A. at 750. See also *Jeffs v. Utah Power and Light Co.*, 136 Me. 454, 465 12 A.2d 592 (1940). Although it can be argued that by applying the continuing wrong exception to the contemporaneous ownership rule, see note 1, *supra*, the Maine court impliedly acknowledged that Maine law required contemporaneous ownership in shareholder actions, the court's cryptic statement is indeed "too enigmatic to be very helpful." Field, McKusick and Wroth, Maine Civil Practice, *supra*.

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100 A. 645 (1917); *Home Fire Insurance Co. v. Barber*, *supra*. Nor does characterizing the actions as claims arising under federal statutes save them from the scrutiny of equity. *Columbia Nitrogen Corp. v. Royster Co.* 451 F.2d 3, 15-16 (4th Cir. 1971) (antitrust laws); *Royal Air Properties, Inc. v. Smith*, 312 F.2d 210, 213-214 (9th Cir. 1962) (securities laws). See also *Edwin L. Wiegand Co. v. Harold E. Trent Co.*, 122 F.2d 920, 925 (3rd Cir. 1941) (copyright laws). The equitable principle that the corporate form "will not be allowed to be pushed to the extent of furthering injustice rather than justice" is well established, and has been applied to cases where the plaintiff attempted to use the corporate form to achieve results which he could not accomplish in his own right. *Western Battery & Supply Co. v. Hazelett Storage Battery Co.*, 61 F.2d 220, 230 (8th Cir. 1932), cert. denied, 288 U.S. 608, 53 S.Ct. 399, 77 L. Ed. 982 (1933); *Shamrock Oil and Gas Co. v. Ethridge*, 159 F.Supp. 693 (D. Colo. 1958). Since Amoskeag, which did not itself incur any damage as a result of defendants' alleged wrongful acts, and not the corporate plaintiffs, is the real beneficiary of any recovery which might be had in the name of the corporate plaintiffs, the corporate claims must fail for lack of equity on the part of those who would ultimately benefit from any corporate recovery.

The applicable principle was stated long ago by Dean Roscoe Pound, then a Commissioner of the Supreme Court of Nebraska, in the leading case of *Home Fire Insurance Co. v. Barber*, *supra*:

Where a corporation is not asserting or endeavoring to protect a title to property, it can only maintain a suit in equity as the representative of its stockholders. If they have no standing in equity to entitle them to the relief sought for their benefit, they cannot obtain such relief through the corporation or in its own name. (citations omitted). It would be a reproach to courts

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of equity if this were not so. If a court of equity could not look behind the corporation to the shareholders, who are the real and substantial beneficiaries, and ascertain whether these ultimate beneficiaries of the relief it is asked to grant have any standing to demand it, the maxim that equity looks to the substance, and not the form, would be very much limited in its application. 67 Neb. at 664-665, 93 N.W. at 1031-1032.

In *Home Fire*, the court sustained a corporate claim, which it considered to be brought at law, to recover company monies wrongfully withdrawn by Barber and converted to his own use. But the court denied recovery by the corporation upon claims, which it considered to be brought in equity, for corporate mismanagement and waste allegedly committed by Barber, where the existing stockholders, who would be the real beneficiaries of a recovery, had acquired their stock subsequent to the acts complained of, and were hence found to have no standing in equity.

The case of *Amen v. Black*, *supra*, presented facts similar to the instant case. In *Amen*, a corporation, through its receivers, asserted claims for recovery of the profits allegedly realized by Black, its former president and chairman of the Board, from the improper use of company funds and from the sale of corporate stock which Black had wrongfully obtained from the corporation and later sold to N.C.R.A. The court denied relief to the corporation, holding:

Looking at the substance of the corporate claims and the beneficiaries thereof, it becomes readily apparent that the principal beneficiary of any recovery on behalf of the corporation would be the N.C.R.A. who became the principal stockholder upon the purchase of a majority of the stock in 1947. And having

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purchased the stock of the corporation from Black in an arms length transaction, and having received the full value of its purchase, any recovery as stockholder beneficiary of the dissolved corporation would be tantamount to recoupment of the legitimate purchase price of the stock. Obviously there are no equities in such a result, and we therefore hold that the corporate claims must fail for lack of standing to maintain the suit and for want of equity on the part of the beneficiaries in any corporate recovery. 234 F.2d at 23.

Similarly, in *Matthews v. Headley Chocolate Co.*, *supra* Headley Chocolate Company commenced an action against Matthews and six other former directors and controlling shareholders to recover damages for the alleged wrongful misappropriation of corporate assets. Subsequent to the alleged wrongs, Matthews had sold a controlling interest in the corporation to one Rodda and his associates. After concluding that Rodda would be barred from maintaining a derivative action, the court stated:

The question then is whether this bill can be sustained in the name of the corporation, and, if so, how the defendants can be protected from claims we have spoken of as not entitled to relief. Inasmuch as by the change of the majority of stock those who were minority stockholders at the time of the transactions complained of are now able to have the suit brought in the name of the company, we are of the opinion that it can be maintained, in that name, instead of in the names of the minority stockholders but for their benefit. But while that is so, if there be any recovery by reason of the claims spoken of, it can only be to the extent of the proportions of the sum recovered due such minority stockholders, if any, as are not barred by

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laches, limitations, acquiescence, or other way sufficient to bar them in equity, and anything recovered should be directed to be paid to them by the corporation. Any defense that could have been made against the minority stockholders if they had sued in their own names should be allowed, notwithstanding the fact that the suit is in the name of the corporation. It seems to us that that course is the only one which in equity and justice can be adopted in this case. The purchasers from Matthews have lost nothing, so far as the bill discloses, and if he deceived them in the sale, they have their remedy against him individually, but they should not be permitted to use the corporate name to veil defects in the title to the stock transferred to them by the former stockholder who received about two-thirds of the amounts claimed to have been improperly paid. 130 Md. at 536-537, 100A. at 651.

Thus, the court in *Headley Chocolate*, while holding that the corporation had standing to sue, held it could recover only for those minority stockholders who held their shares at the time of the alleged wrongs and who were not barred by any equitable defenses. In the present case, plaintiffs have expressly disclaimed that they are seeking a proportionate recovery on behalf of the 1% minority stockholders in BAR.

The principle that a suit cannot be brought by a corporation where the ultimate beneficiaries of a corporate recovery would be barred was also applied in *Capitol Wine and Spirit Corp. v. Pokrass*, 277 App. Div. 184, 98 N.Y.S.2d 291 (1st Dep't. 1950), aff'd, 302 N.Y. 734, 98 N.E.2d 704 (1951).

Research has disclosed no case the holding of which is contrary to that of the foregoing authorities. In *Central*

December 29, 1972, District Court Opinion

Railway Signal Co. v. Longden, 194 F.2d 310 (7th Cir. 1952), cited by plaintiffs, the court found that there had been no change of ownership of the plaintiff corporation subsequent to the time of the acts complained of. *Id.* at 321. The court's comments on the present question were dictum unnecessary to the decision of the case, and in any event the court seems to be saying no more than that Fed. R.Civ.P. 23 (b) (the predecessor of Rule 23.1) does not apply to a suit by a corporation. *Idem.* Furthermore, it does not appear that Longden, the alleged wrongdoer, was a controlling stockholder, or that the owner of 99% of plaintiffs' stock at the time of suit had acquired its shares from stockholders who had participated in Longden's wrongdoing.

Plaintiffs' final argument is that defendants are in no position to assert equity because if recovery is here denied defendants will be able to keep the fruits of their allegedly wrongful acts. The same argument was made by the plaintiff and rejected by the court in *Home Fire Insurance Co. v. Barber*, *supra*. In the words of Dean Pound:

But it is said the defendant Barber, by reason of his delinquencies, is in no position to ask that the court look behind the corporation to the real and substantial parties in interest. . . . We do not think such a proposition can be maintained. It is not the function of courts of equity to administer punishment. When one person has wronged another in a matter within its jurisdiction, equity will spare no effort to redress the person injured, and will not suffer the wrongdoer to escape restitution to such person through any device or technicality. But this is because of its desire to right wrongs, not because of a desire to punish all wrongdoers. If a wrongdoer deserves to be punished, it does not follow that others are to be enriched at his expense by a court

December 29, 1972, District Court Opinion

of equity. A plaintiff must recover on the strength of his own case, not on the weakness of the defendant's case. It is his right, not the defendant's wrongdoing, that is the basis of recovery. When it is disclosed that he has no standing in equity, the degree of wrongdoing of the defendant will not avail him. 67 Neb. at 673, 93 N.W. at 1035.

For the reasons stated, defendants' motion for summary judgment dismissing the entire complaint is granted.

It is so ordered.

August 3, 1973, First Circuit Opinion
UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 73-1059

BANGOR AND AROOSTOOK RAILROAD COMPANY, ET AL.,
Plaintiffs, Appellants,
v.

BANGOR PUNTA OPERATIONS, INC., ET AL.,
Defendants, Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MAINE

Before COFFIN, Chief Judge,
McENTEE and CAMPBELL, Circuit Judges.

Edward T. Robinson and Alan L. Lefkowitz, with whom Ely, Bartlett, Brown & Proctor, Roger A. Putnam, Howard H. Dana, Jr., and Verrill, Dana, Philbrick, Putnam & Williamson were on brief, for appellants.

James V. Ryan, with whom C. Kenneth Shank, Jr., Bruce Topman, Webster, Sheffield, Fleischmann, Hitchcock & Brookfield, Sumner T. Bernstein, Herbert H. Sawyer, and Bernstein, Shur, Sawyer & Nelson were on brief, for appellees.

August 3, 1973

CAMPBELL, Circuit Judge. A Maine railroad corporation and its wholly-owned subsidiary bring this action

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against their former owners, seeking damages under the federal anti-trust and securities laws, and under state law, for the alleged "looting" of the railroad in 1960-67 when the defendants were in control. Over 99% of its stock was purchased from the old owners after the alleged wrongs. The district court granted defendants' motion for summary judgment, holding that the railroad could not maintain what it termed "typical stockholder claims seeking an accounting for alleged misappropriation and waste of corporate assets by controlling stockholders" since the present owner was not a stockholder at the time of the alleged improper transactions and was not injured thereby. 353 F. Supp. 724, 728 (D. Me. 1972).

Plaintiff, Bangor and Aroostock Railroad Company (BAR),¹ operates a railroad in northern Maine. Plaintiff, Bangor Investment Company (BIC), a Maine corporation, is a wholly-owned subsidiary of BAR. Defendant, Bangor Punta corporation (Bangor Punta), a Delaware corporation the stock of which is listed upon the New York Stock Exchange, is a diversified holding company. Defendant, Bangor Punta Operations, Inc. (BPO), a New York Corporation, is a wholly-owned subsidiary of Bangor Punta.

Bangor Punta, in 1964, through its subsidiary BPO, acquired 98.3% of the stock of BAR, by acquiring all the

¹ It is alleged in the complaint that BAR "is a Maine Corporation organized in 1891 for the purpose of constructing, maintaining and operating a railroad for public use, and has its principal place of business in Bangor, Maine. It operates a railroad providing essential services for those persons and businesses located in the northern part of the State of Maine. BAR connects within the State of Maine with other railroads which serve the northeastern part of the United States, and which, in turn, connect with other railroads serving the remainder of the United States. Freight shipments of BAR consist of products grown and manufactured in the State of Maine, including potatoes, pulp and paper products, which are sold and used in other parts of the United States."

August 3, 1973, First Circuit Opinion

assets of Bangor and Aroostock Corporation (BAC), a Maine holding company established by BAR in 1960. Bangor Punta, through BPO, continued to own 98.3% of BAR's outstanding stock until October 2, 1969, at which time, for \$5,000,000, it sold its stock interest in BAR to Amoskeag Company (Amoskeag), a Delaware investment corporation controlled by Frederick C. Dumaine, Jr. Amoskeag later bought additional BAR shares, and now owns over 99% of all the outstanding stock of BAR.

The complaint contains thirteen counts. Damages totaling \$7,000,000, for BAR only, are sought on grounds of mismanagement, misappropriation and waste of corporate assets caused by four intercompany transactions taking place among BAC, Bangor Punta, BAR and BIC during the years 1960-67, while BAC and then Bangor Punta were in control of BAR and BIC. The defendants are said to have violated § 10 of the Clayton Act, 15 U.S.C. § 20, and § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder. They are also alleged to have violated the Maine common law and Section 104 of the Maine Public Utilities Act, 35 M.R.S.A. § 104.

The wrongful acts allegedly included overcharge by BAC and BPO for services to BAR; causing BAR to excuse BAC and BPO from interest payments due on loans and to pay improper dividends; the improper acquisition of St. Croix Paper Company stock owned by BAR through BIC; and causing BIC to engage in improper borrowings. In essence, defendants are alleged to have "dominated and controlled BAR and exploited it solely for their own purposes, to the injury of BAR and without regard to BAR's future obligations both to its creditors and to the public which it serves. By such domination, control and exploitation, [defendants] calcula-

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tedly drained the resources of BAR in violation of law for their own benefit. . . ."

The defendants moved for summary judgment "dismissing the entire complaint, as amended herein, with prejudice, for the reason that the complaint fails to state a cause of action on behalf of the corporate Plaintiffs; or in the alternative . . . dismissing each of Count II and Count V [brought under the Maine Public Utilities Act] of the amended complaint herein, with prejudice, for the reason that each of them fails to state a cause of action."

The district court granted defendants' motion, stating,

"Defendants seek dismissal of the entire complaint on the ground that Amoskeag, which would be the sole beneficiary of any recovery by the corporate plaintiffs, was not a stockholder of BAR at the time of the alleged improper transactions and itself sustained no injury as a result thereof. The Court agrees. Since the Court therefore concludes that the entire complaint must be dismissed, it does not reach defendants' alternative motion for dismissal of Counts II and V." 353 F. Supp. at 726.

Starting with the proposition that F.R.C.P. 23.1, the so-called contemporaneous ownership rule, would apply to a shareholder's derivative action brought to enforce the claims asserted here, the district court reasoned that Amoskeag, by causing the plaintiff corporations (essentially BAR) to bring this action, was attempting to accomplish indirectly what it could not do directly; namely, to bring "typical stockholder claims" for misappropriation and waste. Since Amoskeag,

"which did not itself incur any damage as a result of defendants' wrongful acts, and not the corporate plaintiffs, is the real beneficiary of any recovery

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which might be had in the name of the corporate plaintiffs, the corporate claims must fail for lack of equity on the part of those who would ultimately benefit from any corporate recovery." 353 F. Supp. at 728.

The district court relied on Commissioner Roscoe Pound's opinion in *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 661-62, 93 N.W. 1024, 1030-31 (1903), and like cases. See, e.g., *Capitol Wine & Spirit Corp. v. Pokrass*, 277 App. Div. 184, 98 N.Y.S.2d 291, *aff'd*, 302 N.Y. 734, 98 N.E.2d 704 (1951); *Amen v. Black*, 234 F.2d 12, 23 (10th Cir. 1956). *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 A. 645 (1917). *Home Fire* and its successors hold that a person who was not a stockholder at the time of the alleged mismanagement of a corporation may not later sue derivatively, nor, if he becomes the sole stockholder, may he cause the corporation itself to sue. Central to the conclusion that even the corporation may not sue is the assumption that "the shareholders . . . are the real and substantial beneficiaries of a recovery." *Home Fire Ins. Co. v. Barber*, *supra*, 67 Neb. at 664, 93 N.W. at 1031. Equity, "penetrating all fictions and disguises", treats the corporation as the alter ego of its stockholders: because it would be unjust to enrich them, the corporation may not be enriched. A corollary is that the corporation is barred from suing only if recovery would inure solely to the benefit of the estopped stockholders. If other eligible interests, such as creditors or minority shareholders, would benefit, the corporation may sue; since recovery is for the corporation the estopped stockholders would also benefit, but that is "an injustice which might be necessary to be suffered. . . ." *Capitol Wine & Spirit Corp. v. Pokrass*, *supra*, 98 N.Y.S.2d at 293.

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The *Home Fire* rule prevents a purchaser of all or most of the corporate stock, who probably purchased it at a price tied to the value of the assets at the time of sale, from recovering a windfall. Where maintenance of the corporate cause of action serves no other interest, such a result seems reasonable—although we leave open whether the equities reflected in *Home Fire* should be permitted to prevent suits under laws, such as the federal anti-trust and securities acts, that were enacted to protect interests other than, or in addition to, those of the current stockholders. Cf. *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 139 (1968).

Our difficulty here, however, is more fundamental. Even accepting *Home Fire*, we doubt its applicability. We reject the premise—critical both to the district court's holding and to the *Home Fire* rationale—that BAR's chief stockholder, Amoskeag, would be the "sole beneficiary" of a recovery for BAR. The premise, applied to a rail carrier, seems to us to be an over-simplification, although, without doubt, BAR's recovery would be highly beneficial to Amoskeag. Because of the nature of their services and of regulatory restrictions affecting them, and, more generally, because of their legal status as "quasi-public corporations", railroads cannot realistically be described as mere alter egos of their chief stockholders. If BAR's management complies with the law, recovery of monies by BAR may be expected not only to benefit its stockholders but to improve the economic position of the carrier, enabling it to enhance its services and helping stave off the financial crisis faced today by so many railroads. The net result will be of likely benefit to the public. Such considerations might be irrelevant in cases involving ordinary, closely held businesses; their survival is not usually deemed to be of public concern and they are typically

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viewed as mere projections of their stockholders. But courts — even before passage of extensive regulatory laws — have for years held that the public has an identifiable interest in a railroad corporation and in its ability — including its financial ability — to provide services and, indeed, to survive.

The public's interest, unlike the private interest of stockholder or creditor, is not easily defined or quantified, yet it is real and cannot, we think, be overlooked in determining whether the corporation, suing in its own right, should be estopped by equitable defenses pertaining only to its controlling stockholder. Here we think the public's interest in the financial health of BAR provides a separate interest, quite apart from Amoskeag's, which is served by the corporate cause of action.² Thus, regardless of

²Under the view we take of the case, we need not consider the district court's conclusion that the present suit is not being maintained in any meaningful way on behalf of the less than 1% of stock not owned by Amoskeag.

Nor do we analyze the extent to which the contemporaneous stock ownership rule is mandated, in a non-derivative action, by F.R.C.P. 23.1. Whether a stockholder is equitably barred from suit because he did not own the stock at the time of the alleged wrong or because he acquired it from wrongdoers is significant here only if we accept the district court's premise—as we do not—that BAR's controlling stockholder is the sole beneficiary of the instant litigation.

It can be argued, of course, that F.R.C.P. 23.1, dealing with derivative suits, does not establish a federal rule of contemporaneous ownership with respect to non-derivative proceedings. The underlying policies for adoption of the Rule—preventing transfer of a few shares to a non-resident to acquire diversity jurisdiction and to discourage strike suits—relate to abuses associated with minority stockholder proceedings. See *Hawes v. Oakland*, 104 U.S. 450 (1882); 3B Moore's Federal Practice, ¶ 23.1.15. The Maine Supreme Judicial Court has recently indicated willingness to relax the contemporaneous ownership requirement where fairness and sound policy warrant. See *Forbes v. Wells Beach Casino, Inc., et al.*, Docket No. 930, Law Docket No. 1688, June 28, 1973.

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the latter's motivations or potential receipt of undeserved benefits, BAR should be permitted, and indeed has a duty, to recover for itself any assets which were divested from it in violation of state or federal law.

A railroad is a "public" or "quasi-public" corporation. *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290, 321-22, 332-33 (1897); *Railroad Com'rs v. Portland and O.C.R.R.*, 63 Me. 269, 18 Am. Rep. 208 (1872); for a recent state case reaffirming the traditional concept, see *Louisville and Nashville Ry. v. Sutton*, 436 S.W.2d 487, 490 (Ky. Ct. App. 1969); see generally 1 Fletcher Cycl. Corps., § 63 (1963). According to the Maine Supreme Judicial Court,

"Railroad charters are contracts made by the legislature in behalf of every person interested in anything to be done under them." *Railroad Com'rs v. Portland and O.C.R.R.*, *supra*, 63 Me. at 278.

The provision of roads and "other artificial structures" for travel is a duty of government recognized from earliest times. *Id.* at 275. The granting of a franchise to operate a railroad was seen by the Maine court as a farming-out by government of a duty owed to the public.

"The fare is the consideration for the service performed, whether done by the State directly, or by a corporation under a grant from the State; it is simply a substitute for the tax rendered necessary when the State builds and conducts railroads at the public expense; the corporation, upon the payment of the fare, is under the same obligation to render the required service for the public, that the State would be, if railroads were free, and conducted by State authority. Nor does the ownership of railroads, whether it be

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in the State or a private corporation, affect the nature of their use, since in either case the function to be exercised and the uses to be subserved are public." *Id.* at 275-76.

It can, of course, be argued that all manner of businesses are affected with a public interest. See *Munn v. Illinois*, 94 U.S. 113 (1877) (regulation of private grain elevators). However that may be, railroads, involving the use and often the forced taking of interests in land³ and providing essential transportation, have acquired a unique status in our law; they were said by the Maine court in *Railroad Com'rs v. Portland and O.C.R.R.*, *supra*, 275, to be "pre-eminent" among private instrumentalities affected with a public interest. While the development of other modes of transportation has eroded this "preeminence", the Maine courts have not modified their view of the unique legal status of railroad companies, which are also regulated "public utilities" under Maine law, 35 M.R.S.A. § 15.13 *et seq.*

Federal courts, including the Supreme Court, early took the same view of the public or quasi-public character of railroads. In *United States v. Trans-Missouri Freight Ass'n*, *supra*, 166 U.S. at 332-33, the Supreme Court said,

"... railways are public corporations organized for public purposes, granted valuable franchises and privileges, among which the right to take the private property of the citizen *in invitum* is not the least, ... many of them are donees of large tracts of public

³ Beginning in 1850, Congress lavishly subsidized railroad construction by land grants: for example, an estimated 40,000,000 acres was granted to the Northern Pacific, *Great Northern Ry. v. United States*, 315 U.S. 262, 276 (1942). Under Maine law, land may be taken for railroad purposes by eminent domain. 35 M.R.S.A. § 651 *et seq.*

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lands and of gifts of money by municipal corporations, and . . . they all primarily owe duties to the public of a higher nature even than that of earning large dividends for their shareholders. The business which the railroads do is of a public nature, closely affecting almost all classes in the community . . ."

More recently, the public importance of the rail carriers has been recognized in context of the economic crisis threatening their continued existence. Indeed, since the temporary nationalization of the railroads in World War I, the preservation of the railroads has been a national concern. Interpreting the Transportation Act, 1920, Mr. Justice Brandeis said,

"By that measure, Congress undertook to develop and maintain, for the people of the United States, an adequate railway system. It recognized that preservation of the earning capacity, and conservation of the financial resources, of individual carriers is a matter of national concern; . . ." *Texas & Pac. Ry. v. Gulf, etc. Ry.*, 270 U.S. 266, 277 (1926).

In 1933, Congress added Section 77 to Chapter VIII of the Bankruptcy Act, providing for the financial reorganization of ailing railroads. A policy of Section 77 is "that the operation of railroads as sound, economic units should be achieved for the benefit of the public, regardless of the interests of creditors and stockholders." 5 *Collier on Bankruptcy*, 14th ed., ¶ 77.02. p. 469. In *Reconstruction Finance Corp. v. Denver & R.G.W.R.R.*, 328 U.S. 495, 536 (1946), the Court said, "[B]y their entry into a railroad enterprise, [security holders] assumed the risk that in any depression or any reorganization the interests of the public would be considered as well as theirs." See *New Haven Inclusion Cases*, 399 U.S. 392, 492 (1970). Cf. Note,

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Takings and the Public Interest in Railroad Reorganization, 82 Yale L.J. 1004 (1973). Worry over the public effect of the Northeastern railroads' insolvency appears in the Interstate Commerce Commission's *Northeastern Railroad Order of Investigation* (Ex Parte No. 293, Feb. 7, 1973, 38 Fed. Reg. 6253 (1973)), noting the entry into Section 77 reorganization of seven Class I railroads, and the danger that acute cash crises of several might lead to the eventual cessation and liquidation of the transport facilities of the carriers. The I.C.C. found these matters to "create implications of nationwide importance." Similar concern resulting from the Penn Central financial crises was expressed in Senate Joint Resolution 59 approved Feb. 9, 1973 (P.L. 93-5, 87 Stat. 5, 1973 U.S. Code Cong. & Ad. News 379).

In 1960 the Maine Supreme Judicial Court concluded that local freight lines (BAR is one such) were crucially important to the Maine economy. The court said, in *Maine Cent. R.R. v. Public Utilities Comm'n*, 156 Me. 284, 163 A.2d 633, 637 (1960):

"There can be no question as to the very real need which the whole public of Maine has for an efficient freight service by rail. There are many raw materials and products of great weight and bulk which can only be carried efficiently in and out of Maine in freight cars. This state is somewhat remote from the principal markets and thus dependent on fast and economical transportation of goods. We are engaged in spirited competition with our sister states for new industry which will add to payrolls and taxes and assure the economic health of Maine. Moreover, existing established industry must be encouraged and preserved and agriculture must not be deprived of indispensable freight service. Here we are dealing with

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the *public interest* in its broad sense for every citizen of Maine has a stake in the industrial and economic vitality of his state.”

Given today’s circumstances of which we are all generally aware, and the legal history above cited, it would be unrealistic to treat a railroad’s attempt to secure the reparation of misappropriated assets as of concern only to its controlling stockholder. To do so grants to the defendants an undeserved immunity from suit, to the disadvantage of the public, solely to avoid a windfall to Amoskeag which, whatever its own lack of equity, is neither a wrongdoer nor a participant in any wrong. We see BAR and its management as seeking a corporate recovery in which the public has a real, if inchoate interest. Amoskeag’s windfall is irrelevant to that interest, and should not be the factor which determines whether or not BAR may sue.

Moreover, to prevent BAR from suing to recover assets wrongfully divested is to reject the use of private litigation as a deterrent to patently undesirable conduct. The management of a rail carrier — whoever it may be and whatever its private aims — is best situated to learn of wrongs to the railroad and to take effective action to redress them. The looting of a railroad and its possible decline or even failure are so clearly violative of state and federal policies, as expressed both in legislation and in the decisions of courts, as to invite the encouragement of private lawsuits as a supplement to public enforcement. See *J. I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964); *Perma Life Mufflers, Inc. v. International Parts Corp.*, *supra*, 392 U.S. at 139. The private financial incentive for those bringing the action helps assure that it will be brought; federal and state agencies, sometimes hampered by inadequate funding or diverted by other concerns, may not be able to take the necessary action.

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Thus we hold that neither the federal nor the state courts are foreclosed by the failure of BAR's principal stockholder to own its stock during the period of the wrongful conduct nor by Amoskeag's purchase of the stock from the alleged wrongdoers.

We are left with a final major question which we do not now attempt to resolve; namely, the extent, if any, to which the district court should try to insure that recovery, if any, does not benefit Amoskeag at the expense of the railroad and the public which it serves. If BAR should recover, Amoskeag's BAR stock will increase in value. An increase in stock value is a windfall which can hardly be avoided; it would not be inconsistent with the public's interest in a healthier railroad. On the other hand, a syphoning off of BAR's recovery into the pockets of present stockholders or others would be different. Hopefully, the very logic by which appellants are allowed to sue here may help to deter at least illegal distributions. In any event, we have no doubt of the power of the district court, in conjunction with any recovery, to enter orders, if appropriate, prohibiting distributions by BAR that would conflict with state or federal law. A more difficult question arises with respect to its ability to enter more sweeping prohibitions to ensure that BAR's recovery is not unreasonably diverted for the private enrichment of its stockholders.

If plaintiffs prevail, the latter is a matter which the parties and the district court may consider further, possibly with the invited assistance of state and federal agencies. Our ruling that the plaintiffs may sue is not conditioned on the devising of court-imposed limitations on the uses of any corporate recovery. Even without limitations, the public interest is better served than were civil immunity to be assured to those who may have

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syphoned funds from a rail carrier in violation of State and federal law. Whether a court could properly or practicably regulate (beyond existing state and federal law) the use which a carrier might make of any recovered funds, we are not prepared to decide at this time.

We understand the district court's order for summary judgment to be based solely on its determination that plaintiffs were barred from suing because of Amoskeag's failure to own stock at the time of the alleged wrongs and its purchasing of stock from alleged wrongdoers. Our decision reverses that determination; it leaves all other issues open, including the merits of plaintiffs' claims, which have yet to be tried. The district court not having ruled thereon, we express no opinion on defendants' motion, on different grounds, to dismiss Counts II and V.

Reversed and remanded for proceedings consistent herewith.

Statutes and Regulations Involved

1. Clayton Act § 10, 15 U.S.C. § 20, reads in pertinent part as follows:

No common carrier engaged in commerce shall have any dealings in securities, supplies, or other articles of commerce, or shall make or have any contracts for construction or maintenance of any kind, to the amount of more than \$50,000, in the aggregate, in any one year, with another corporation, firm, partnership, or association when the said common carrier shall have upon its board of directors or as its president, manager, or as its purchasing or selling officer, or agent in the particular transaction, any person who is at the same time a director, manager, or purchasing or selling officer of, or who has any substantial interest in, such other corporation, firm, partnership, or association, unless and except such purchases shall be made from, or such dealings shall be with, the bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding under regulations to be prescribed by rule or otherwise by the Interstate Commerce Commission. No bid shall be received unless the name and address of the bidder or the names and addresses of the officers, directors, and general managers thereof, if the bidder be a corporation, or of the members, if it be a partnership or firm, be given with the bid.

2. Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

3. SEC Rule 10b-5 (17 C.F.R. § 240.10b-5) reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange.

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

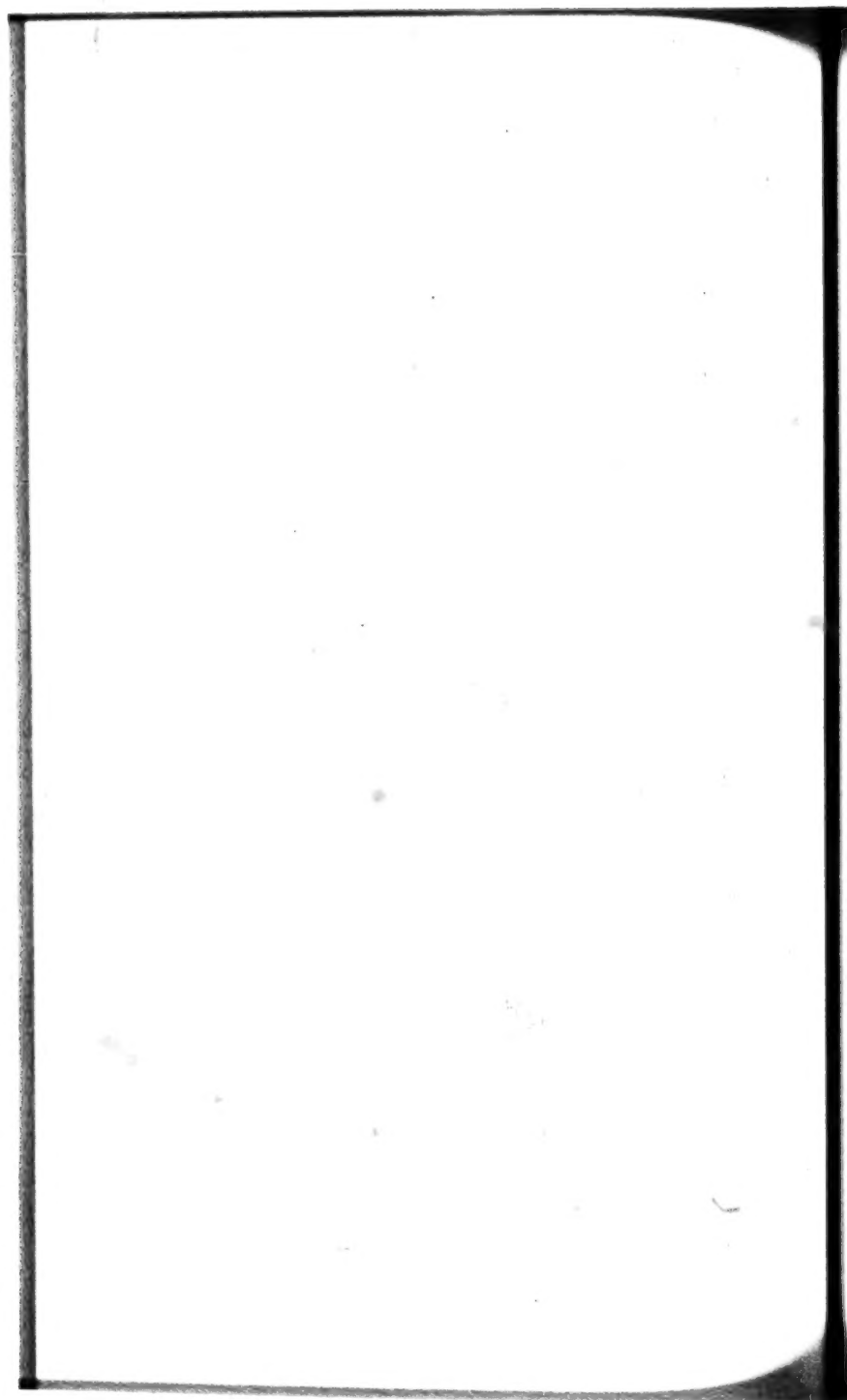
(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

4. Federal Rule of Civil Procedure 23.1 reads as follows:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a share-

holder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.



FILE COPY

DEC 8 1973

No. 73-718

MICHAEL RODAK, JR.

IN THE
Supreme Court of the United States
October Term, 1973

BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,
Petitioners

v.

BANGOR & AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,
Respondents

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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November 29, 1973

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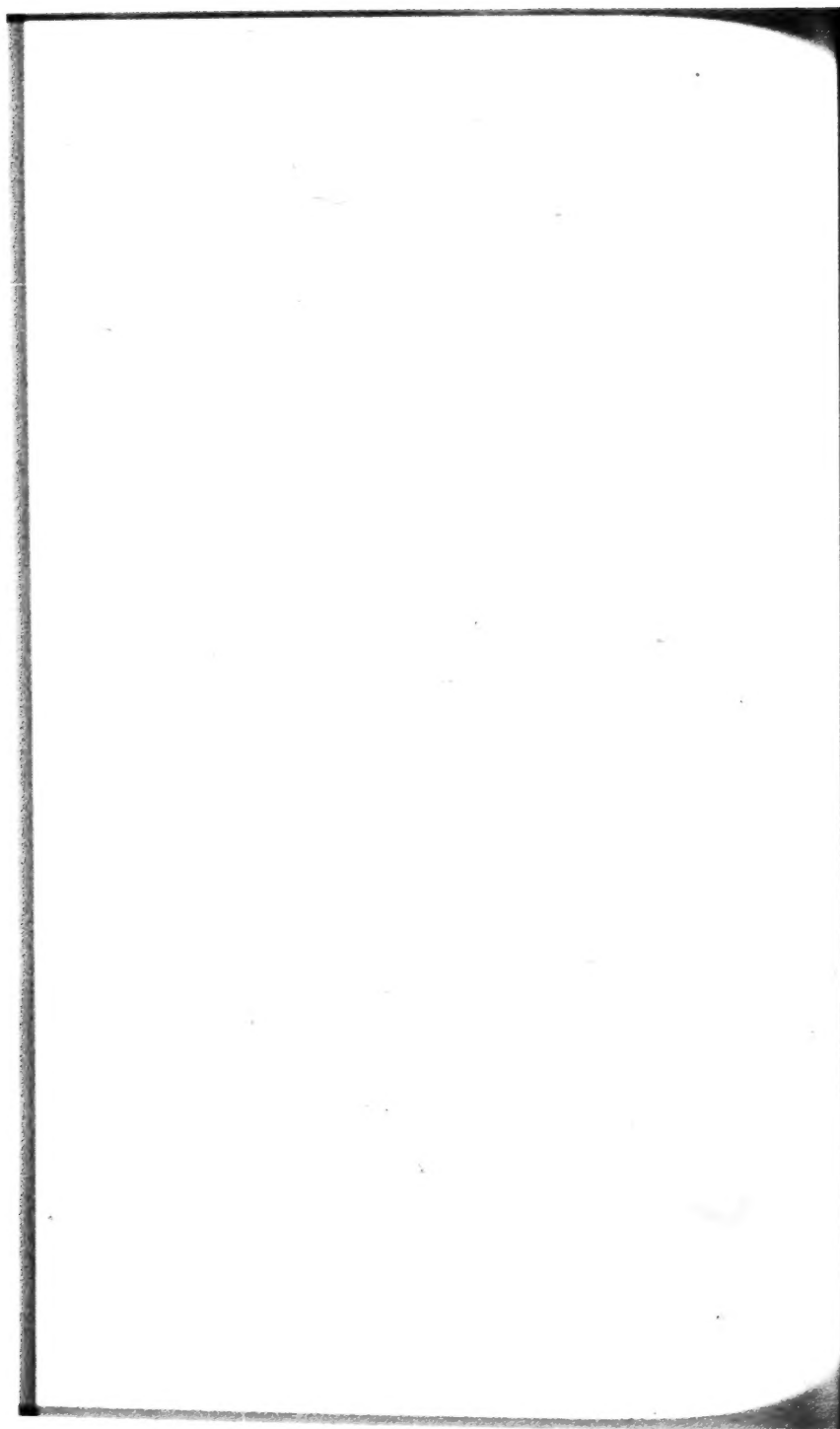
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IN THE
Supreme Court of the United States

October Term, 1973

No. 73-718

BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,
Petitioners

v.

BANGOR & AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,
Respondents

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

Opinions Below

The opinion of the District Court is reported at 353 F.Supp. 724 (D. Me. 1972). The opinion of the Court of Appeals is reported at 482 F.2d 865 (CA1 1973).

Jurisdiction

The judgment and order of the Court of Appeals was entered August 3, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Whether the decision below correctly allowed a corporation to sue in its own name and behalf for depredations committed upon it by a former majority stockholder where the recovery will benefit persons in addition to present stockholders, distinguishing a 1903 state court equity decision, *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N.W. 1024, and like cases.

2. Whether the decision below correctly held that the contemporaneous ownership requirement for derivative actions brought by stockholders does not apply to a suit brought by a corporation in its own name and behalf.

3. Whether the decision below, which involves the scope of an equitable defense in a suit between private parties, conflict with *Sierra Club v. Morton*, 405 U.S. 727 (1972), which involves review of administrative action under the Administrative Procedure Act.

Statutes, Rules, and Regulations Involved

Respondents maintain that no statutes, rules, or regulations are involved in the decision below. The text of the following statutes and rules are set out in the appendixes for the convenience of the court:

- 1) Rule 10b-5 [17 C.F.R. § 240.10b-5], adopted by the Securities and Exchange Commission pursuant to § 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] Appendix A, at p. 14
- 2) Section 10 of the Clayton Act [15 U.S.C. § 20] Appendix B, at p. 14
- 3) Sections 15 and 104 of the Maine Public Utilities Act [35 M.R.S.A. §§ 15 and 104] Appendix C, at p. 15
- 4) Rule 23.1, F.R.Civ.P. Appendix D, at p. 17

Statement of the Case

This suit is brought by the Bangor and Aroostook Railroad Company (BAR) and its wholly owned subsidiary the Bangor Investment Company (BIC). BAR is a Maine corporation organized in 1891. It operates a railroad providing essential services for those persons and businesses located in the northern half of Maine. Its Comparative General Balance Sheet as contained in the Railroad Annual Report, Form A, for the year ending December 31, 1972, as filed with the Interstate Commerce Commission, shows assets of \$67,726,890.

This suit was authorized by the BAR Board of Directors. During the summer of 1971 there had been made public a report to the Interstate Commerce Commission prepared by the Bureau of Accounts of the Commission, entitled "Review of Diversified Holding Company Relationships and Transactions of Bangor Punta Corporation." The Report stated:

"The purpose of the review was to explore the impact of the Bangor Punta Corporation on the Bangor & Aroostook Railroad while it was owned by and under the control of this diversified holding company and to determine whether or not the intercompany relationships and resulting financial transactions were detrimental to the carrier."

The Report included a recommendation:

"We recommend that all legal remedies be explored to require the holding company, which sold the carrier, to pay back to the carrier for assets taken with no compensation and charges made where no services were performed."

This Report was discussed at a meeting of the BAR board, attended by fifteen of the seventeen directors, held on July 29, 1971. Since some of the directors were not familiar with the Report, no formal action was taken. On August 26, 1971, copies of the Report were mailed to all the BAR directors. At a subsequent meeting held December 8, 1971, attended by ten directors, outside counsel discussed in detail a draft complaint, naming Bangor Punta Corporation (BP) and Bangor Punta Operations (BPO) as defendants, and explained the legal basis of the various claims contained therein. It was unanimously voted to authorize the BAR Chief Executive Officer to commence and conduct litigation against BP and BPO.

The original complaint was filed in the U.S. District Court for the District of Maine on December 30, 1971, and an amended complaint was filed on August 18, 1972. Both complaints contained thirteen counts asserting violations of § 10(b) of the Securities Exchange Act [15 U.S.C. § 78j(b)]

and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5], § 10 of the Clayton Act [15 U.S.C. § 20], § 104 of the Maine Public Utilities Act [35 M.R.S.A. § 104], and the Maine common law. As examples, one count under each theory will be discussed in detail.

1) *Rule 10b-5*

Count VI alleges that in September 1962, BIC owned 67,789 shares of stock in the St. Croix Paper Company, worth in excess of \$2,000,000. The Bangor & Aroostook Corporation (BAC), the predecessor of BP and BPO, learned from inside sources that the Georgia Pacific Corporation was negotiating with St. Croix to make a tender offer to St. Croix stockholders. Before the information became public and without disclosing this information to either BAR or BIC, BAC caused BAR and BIC to enter into a three-way agreement whereby BAC ended up owning all the 67,789 shares of St. Croix stock. As a result BAR and BIC suffered damages of approximately \$1,500,000, which is the profit that BAC made on the exchange of St. Croix stock for Georgia Pacific stock, which occurred shortly thereafter, and on the subsequent appreciation of Georgia Pacific stock.

2) *Section 10 of the Clayton Act*

Count IV alleges that in September 1962, BAR and BAC, which owned around 97% of the stock of BAR at the time, had nine overlapping directors. As part of the three-way transaction involving the St. Croix stock between BAC, BAR and BIC, described above, some \$1,018,000 par value of BAC preferred stock was transferred to BAR at its par value of \$100 per share. There was no bidding conducted, as required under § 10 of the Clayton Act, to determine the

most favorable bid for the BAR. The fair market value of the BAC preferred stock was substantially less than par and than the fair market value of the St. Croix stock whereby BAR suffered damages.

3) *Maine Public Utilities Laws: 35 M.R.S.A. § 104*

Count II alleges that through the years, first BAC and then its successor BPO, all the while owning in excess of 97% of BAR's voting stock, billed BAR for "corporate charges" and received payment from BAR of the following amounts:

<i>Year</i>	<i>Amount</i>
1962	\$ 70,000
1963	96,000
1964	155,000
1965	165,000
1966	204,000
1967	120,000
	<hr/>
	\$810,000

None of these contracts, arrangements or payments was submitted to the Maine Public Utilities Commission for approval as required,* and, in fact, these arrangements were adverse to the public interest and would have been disapproved if submitted, because virtually no services were actually performed for BAR. Thus, BAR was damaged by paying out cash without receiving any consideration in return.

* Under Maine law railroads are public utilities. 35 M.R.S.A. § 15. See Appendix C. p. 16-17.

4) *Maine Common Law: Conversion*

Count I alleges that the same \$810,000 in payments to BAC and to BPO, as discussed immediately above, were paid out in consideration for nothing but nominal services, and that the payments were authorized by officers and directors who were also officers and directors of BAC or BPO, and hence who had conflicting loyalties, and who placed the interests and welfare of BAC and BPO ahead of BAR's. Thus, these payments amount to conversion and misappropriation of assets of BAR.

5) *Other Counts*

The other counts in the complaint included causing BAR to pay illegal special dividends, causing BAR to excuse for no consideration interest payments on debts owed to BAR, and causing BIC to engage in illegal borrowing.

Approximately 99% of the stock of BAR is now owned by the Amoskeag Company (Amoskeag), a diversified operating company, registered under the Securities Exchange Act of 1934*, with its stock publicly held and traded. Amoskeag had purchased about 98% of the stock of BAR from BP and BPO on October 2, 1969, and acquired the other 1% in miscellaneous small transactions since that time. It is alleged that the domination and control of BAR by BP, BPO, and their predecessor, BAC, "resulted in fraudulent concealment of the systematic exploitation of BAR and, further, prevented any effective investigation being made of such exploitation and the commencement of any suit with respect thereto until after BAR was sold in 1969."

* Amoskeag formerly was an investment company, registered under § 8 of the Investment Company Act of 1940, 15 U.S.C. § 80a-8, but this registration ceased by S.E.C. order effective November 3, 1972.

Proceedings in the District Court and the Court of Appeals

On September 14, 1972, BP and BPO filed in the district court a motion for summary judgment, and on December 29, 1972, the district court entered an order granting this motion. The accompanying opinion read in part:

“[W]hether the federal rule [Rule 23.1, F.R.Civ.P.] or Maine law is applicable, Amoskeag could not maintain a derivative action. . . . Amoskeag . . . is attempting to accomplish indirectly what it could not do directly. . . . [P]laintiffs’ [BAR and BIC’s] claims are typical stockholder claims . . . Equitable considerations must be applied in such actions. . . . Since Amoskeag . . . is the real beneficiary . . . , the corporate claims must fail for lack of equity on the part of those who would ultimately benefit from any corporate recovery.” 353 F.Supp. at 728

BAR and BIC filed a *Notice of Appeal* on January 26, 1973.

In an opinion dated August 3, 1973, the court of appeals reversed the district court and held that BAR and BIC could proceed to assert their claims both under federal and state law.

BP and BPO filed their petition for a writ of certiorari with this Court on October 31, 1973.

Reasons for Denying the Writ

- I. The decision below correctly applied traditional equitable principles to hold that a corporation can sue in its own name and behalf for depredations committed upon it by a former majority stockholder where the recovery will benefit persons in addition to present stockholders.

The district court relied upon a 1903 state court equity decision, *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N.W. 1024, to dismiss plaintiffs' suit on the grounds that BAR's chief stockholder, Amoskeag, as the sole beneficiary, would be unjustly enriched by any recovery. The court of appeals found differently:

"We reject the premise—critical both to the district court's holding and to the *Home Fire* rationale—that BAR's chief stockholder, Amoskeag, would be the 'sole beneficiary' of a recovery for BAR. The premise, applied to a rail carrier, seems to us an oversimplification, although, without doubt, BAR's recovery would be highly beneficial to Amoskeag, because of the nature of their services and of regulatory restrictions affecting them, and, more generally because of their legal status as 'quasi-public corporations', railroads cannot be described as mere alter egos of their chief stockholders." 482 F.2d at 868

Having found that there were interests affected by a recovery beyond that of the chief stockholder, the court of appeals concluded, on equitable principles, that the action should be allowed since to do otherwise would be to grant the alleged wrongdoers "an undeserved immunity from suit, to the disadvantage of the public, solely to avoid a windfall to Amoskeag which, whatever its own lack of equity, is neither a wrongdoer nor a participant in any wrong." 482 F.2d at 870-1

The above, we submit, is all that is involved in the court of appeals decision. It is merely an application of traditional equitable principles to avoid letting wrongdoers escape liability for their wrongful actions.

The decision does not enlarge the scope of any federal or state cause of action. It does not deal with the questions of whether plaintiffs have indeed stated causes of action under the Clayton and Securities Exchange Acts, and it specifically reserves the question of whether there are private causes of action under the Maine Public Utilities Act. 482 F. 2d at 867 and 871-2. It does not raise any issues so as to create a conflict with any decision of any federal or state court.

In *Janigan v. Taylor*, 344 F.2d 781, 786 (CA1 1965) certiorari denied 382 U.S. 879, cited with approval in *Affiliated Ute Citizens v. U.S.*, 406 U.S. 128, 155 (1972), the Court of Appeals for the First Circuit stated that "it is more appropriate to give the defrauded party the benefit even of windfalls than to let a fraudulent party keep them." This case applies that earlier language to the facts of this case.

Since the court of appeals has done nothing more than determine that equitable principles allow maintenance of the action, there is, we respectfully submit, no need for further review by this court.

II. The decision below does not conflict with the contemporaneous ownership requirement of Rule 23.1, F.R.Civ.P., because this suit is brought by the corporation itself and not derivatively by a stockholder.

Rule 23.1, F.R.Civ.P., requiring contemporaneous ownership, applies only to actions brought by a *stockholder* in behalf of a corporation that has "failed to enforce a right which may properly be asserted by it." Rule 23.1, F.R.Civ.P. In this case, the *corporation*, BAR, has acted to enforce its rights; Rule 23.1 does not apply. *Central Ry. Signal Co. v.*

Longden, 194 F.2d 310, 321 (CA7 1952) (alternate holding). The court of appeals in its opinion did not treat Rule 23.1 as applying to this case. 482 F.2d at 868, n.2. The contemporaneous ownership rule determines the standing of a stockholder to assert a claim of his corporation in behalf of the corporation. See *Ross v. Bernhard*, 396 U.S. 531, 538 (1970). If the stockholder lacks standing, the court will "abate the action without respect to the merits" so that another stockholder may pick up the suit. *Liken v. Shaffer*, 64 F.Supp. 432, 442 (ND Iowa 1946). But here the BAR board of directors authorized the suit to be brought by BAR itself. Clearly, Rule 23.1 is not applicable.

Nor are the purposes of Rule 23.1 served by applying it in this case. As the court of appeals decision observes: "The underlying policies for the adoption of the Rule—preventing transfer of a few shares to a non-resident to acquire diversity jurisdiction and to discourage strike suits—relate to abuses associated with minority stockholder proceedings." 482 F.2d at 868, n.2. This is neither a strike-suit nor a suit where jurisdiction has been collusively created. There is no basis for the assertion in BP-BPO's petition, p. 11, that the purpose of Rule 23.1 is to prevent uninjured stockholders from benefiting from a corporate recovery. The cases hold that, when a corporation wins a lawsuit, it recovers its full damages, and the damages are not reduced by the percentage of stockholders who acquired their stock after the wrongs for which the corporation was suing. *Norte & Company v. Huffins*, 416 F.2d 1189, 1190-1, (CA2 1969), *Central Ry. Signal Co. v. Longden*, 194 F.2d 310, 322 (CA7 1952), *Overfield v. Pennroad Corp.*, 48 F.Supp. 1008, 1018 (ED Pa 1943).

Since the decision below does not conflict with either the

contemporaneous ownership requirement of Rule 23.1 or the purposes behind the requirement, certiorari should not be granted on this ground.

III. The decision below does not conflict with *Sierra Club v. Morton*, 405 U.S. 727 (1972), because this case involves claims between private parties and not review of administrative action under the Administrative Procedure Act.

In this case two private parties, BAR and BIC, are seeking to recover from two other private parties funds that were wrongfully taken from BAR and BIC. This is not a case involving review of administrative action taken under the Administrative Procedure Act as is *Sierra Club v. Morton*, 405 U.S. 727 (1972), where the court viewed its task as the interpretation of § 10 of the Administrative Procedure Act, 5 U.S.C. § 702. The case of *Data Processing Service v. Camp*, 397 U.S. 150 (1970), also involved review of administrative action under the Administrative Procedure Act and under the federal banking laws.

The absence of conflict with *Sierra Club* and *Data Processing* is highlighted by the failure of BP and BPO even to mention them, either in brief or in oral argument, before either the district court or the court of appeals. Further neither of the courts below discussed or even cited in their opinions *Sierra Club* or *Data Processing*.

Thus, the decision below does not conflict with *Sierra Club* or with *Data Processing*.

Conclusion

Since the decision below correctly applies traditional equitable principles and does not conflict with existing law, the petition for a writ of certiorari should be denied.

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Appendix A

Rule 10b-5 (17 C.F.R. § 240.10b-5), adopted by the Securities and Exchange Commission pursuant to § 10b of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)], reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person

in connection with the purchase or sale of any security.

Appendix B

Section 10 of the Clayton Act [15 U.S.C. § 20] reads in pertinent part as follows:

No common carrier engaged in commerce shall have any dealings in securities, supplies, or other articles of commerce, or shall make or have any contracts for con-

struction or maintenance of any kind, to the amount of more than \$50,000, in the aggregate, in any one year, with another corporation, firm, partnership, or association when the said common carrier shall have upon its board of directors or as its president, manager, or as its purchasing or selling officer, or agent in the particular transaction, any person who is at the same time a director, manager, or purchasing or selling officer of, or who has any substantial interest in, such other corporation, firm, partnership, or association, unless and except such purchases shall be made from, or such dealings shall be with, the bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding under regulations to be prescribed by rule or otherwise by the Interstate Commerce Commission. No bid shall be received unless the name and address of the bidder or the names and addresses of the officers, directors, and general managers thereof, if the bidder be a corporation, or of the members, if it be a partnership or firm, be given with the bid.

Appendix C

Section 104 of the Maine Public Utilities Act [35 M.R.S.A. § 104] reads as follows:

No public utility doing business in this State shall extend credit or make loans to or make any contract or arrangement, providing for the furnishing of management, supervision of construction, engineering, accounting, legal, financial or similar services, or for the furnishing of any service other than those enumerated, with any corporation, person, partnership or trust, holding, controlling or owning in excess of 25% of the

voting capital stock of such public utility, or with any other corporation which is itself owned or controlled by or affiliated with any corporation, person, partnership or trust, holding, controlling or owning a majority of the voting capital stock of such public utility, unless and until such contract or arrangement shall have been found by the commission not to be adverse to the public interest and shall have received their written approval. The commission shall in the case of any utility have the power to exempt herefrom, from time to time, such classes of transactions as it may specify in writing in advance and which in its judgment will not affect the public interest.

Section 15 of the Maine Public Utilities Act [35 M.R.S.A. § 15] reads as follows:

Wherever used or referred to in chapters 1 to 17, unless a different meaning clearly appears from the context:

3. *Common carrier.* "Common carrier" includes every railroad company, express company, dispatch, sleeping car, dining car, drawing-room car, freight line, refrigerator, oil, stock, fruit, car loaning, car renting, car loading and every other car corporation or person, their lessees, trustees, receivers, or trustees appointed by any court whatsoever, operating for compensation within this State; and every corporation or person, their lessees, trustees, receivers or trustees appointed by any court whatsoever, owning, controlling, operating or managing any vessel regularly engaged in the trans-

portation of persons or property for compensation upon the waters of this State or upon the high seas, over regular routes between points within this State. 1961, c. 395, § 23.

...

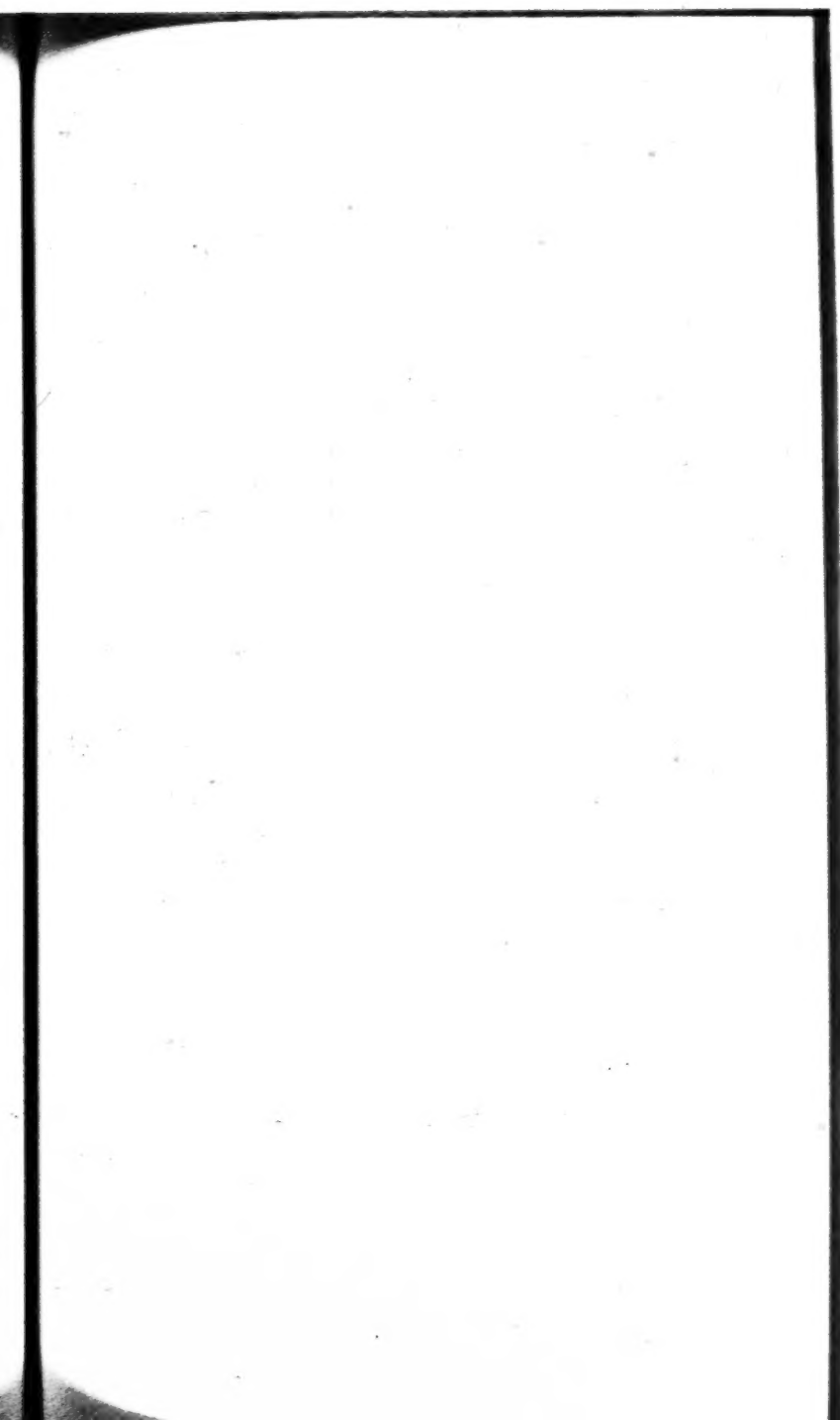
13. *Public utility.* "Public utility" includes every common carrier, gas company, natural gas pipeline company, electrical company, telephone company, telegraph company, water company, public heating company, wharfinger and warehouseman, as those terms are defined in this section, and each thereof is declared to be a public utility and to be subject to the jurisdiction, control and regulation of the commission, and to chapters 1 to 17. 1955, c. 127, § 1.

Appendix D

Rule 23.1, F.R.Civ.P., reads as follows:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to

obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.





FILE
FEB 21 1974

MICHAEL RODAK, J.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 718

BANGOR PUNTA OPERATIONS, INC. and BANGOR
PUNTA CORPORATION,

Petitioners,

v.

BANGOR & AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE PETITIONERS

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February 21, 1974.



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IN THE
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BRIEF FOR THE PETITIONERS

Opinions Below

The opinion of the District Court is reported at 353 F. Supp. 724 (D. Me. 1972) and is reproduced at pp. 30-41 of the Appendix (App.). The opinion of the Court of Appeals for the First Circuit (App. 54-67) is reported at 482 F. 2d 865.

Jurisdiction

The Judgment of the First Circuit, reversing the decision of the District Court, was entered on August 3, 1973. The Petition for a Writ of Certiorari was filed October 31, 1973, and was granted January 7, 1974. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

Questions Presented

(1) Whether a litigant who has himself suffered no injury can bring suit in a federal court to vindicate the rights of the general public.

(2) Whether the fact that a corporation is a railroad or other "public" or "quasi-public" corporation changes the applicable rules with respect to standing so as to permit actions by the general public for alleged violations of the federal securities and anti-trust laws and for common law corporate waste and mismanagement.

(3) Whether the requirement of contemporaneous share ownership embodied in Rule 23.1 of the Federal Rules of Civil Procedure may be evaded in actions involving corporations whose business affects the public welfare.

Statutes and Regulations Involved

The following statutes and regulations are involved: U.S. Const. art. III, § 2; U.S. Const. amend. XI; Clayton Act § 10, 15 U.S.C. § 20; Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b); SEC Rule 10b-5, 17 C.F.R. § 240.10b-5; Interstate Commerce Act, Part I, §§ 1(14), 1(18), 1(21), 5(2)(a), 8, 15(1), 20a(2), 49 U.S.C. §§ 1(14), 1(18), 1(21), 5(2)(a), 8, 15(1), 20a(2); Maine Public Utilities Act § 104, 35 M.R.S.A. § 104; and Rule 23.1 of the Federal Rules of Civil Procedure. The text of pertinent parts of the statutes and regulations are set forth in an appendix to this brief.

Statement of the Case

Plaintiff-respondent Bangor and Aroostook Railroad ("BAR") is a Maine corporation which operates a railroad within the State of Maine. Plaintiff-respondent Bangor Investment Company ("BIC") is its wholly owned subsidiary. Both companies are controlled by Amoskeag Company, ("Amoskeag"), a Delaware corporation which owns 99.3% of the outstanding capital stock of BAR.

Defendant - petitioners Bangor Punta Corporation ("Bangor Punta"), a publicly held Delaware corporation, and Bangor Punta Operations ("BPO"), its wholly owned subsidiary, are former owners of a controlling interest in BAR. BPO owned 98.3% of the capital stock of BAR prior to October 2, 1969, on which date it sold its holdings of BAR stock to Amoskeag for approximately \$5,000,000.

The instant action, brought nominally by BAR and BIC, was commenced on December 30, 1971 and seeks damages of \$7,000,000. Although the complaint frames various causes of action under the common law of Maine; Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) and SEC Rule 10b-5 (17 C.F.R. § 240.10b-5) thereunder; Section 10 of the Clayton Act, 15 U.S.C. § 20; and Sections 104 and 15 of the Maine Public Utilities Act (35 M.R.S.A. §§ 104 and 15), all the counts essentially allege mismanagement and waste of BAR's corporate assets during the time Defendant-petitioners controlled BAR, claims customarily found in the usual shareholders derivative action. The complaint makes no allegation of injury to the public, nor does it allege the suit is brought on the public's behalf.

On September 14, 1972, Defendant-petitioners moved for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. By order dated December 29, 1972, the United States District Court for the District of Maine (Edward T. Gignoux, D.J.) granted Defendant-petitioners summary judgment and dismissed the action on the ground that, from the undisputed facts of the case, Plaintiff-respondents were precluded by well established equitable principles from maintaining the action.

The District Court's opinion emphasized three crucial and uncontested facts (App. 32-33):

(1) the real plaintiff and party in interest, and the beneficiary of any recovery, was Amoskeag, the more than 99% owner of the corporate plaintiffs;

(2) Amoskeag has made no claim that it was defrauded or received less than full value for its

\$5,000,000 purchase price when it bought its BAR stock; and

(3) Amoskeag purchased its BAR stock long after the alleged wrongs to the corporate plaintiffs occurred and suffered no injury from the acts complained of.

On the basis of these undisputed facts showing no injury to Amoskeag, the District Court dismissed the suit. In the District Court's view, the action was in reality a suit by Amoskeag to recover back the full \$5,000,000 it had paid to Bangor Punta, plus an additional \$2,000,000 windfall, while still keeping the BAR stock. The District Court assayed the suit as follows:

"... [L]ooking at the substance of the action, it is evident that the real party in interest is Amoskeag, the present owner of over 99% of the outstanding BAR shares. And having purchased the stock of BAR from Bangor Punta in 1969, long after the events complained of occurred, Amoskeag is clearly attempting, by having the corporations which it controls bring the action in their names, to recover the full \$5,000,000 consideration paid to Bangor Punta for the BAR shares, plus \$2,000,000 more, while still keeping the BAR shares. Amoskeag does not claim that it was deceived or defrauded by Bangor Punta when it purchased its BAR stock, or that it did not get full value for its purchase price. Nor do plaintiffs claim to bring this action on behalf of any creditors or in the public interest. It would accordingly be contrary to settled equitable principles to permit Amoskeag, by thus using the corporate fiction, to acquire a windfall for any past misbehavior on the part of Bangor Punta during the period when Amoskeag had no interest in BAR and sustained no injury, direct or indirect, as a result of Bangor Punta's alleged improper acts." (App. 33)

In holding that the suit could not be maintained, the District Court noted that Amoskeag could not have brought

a derivative action on behalf of BAR for wrongs alleged to have occurred before it bought its shares (App. 33-34)* and held that Amoskeag could not, by causing the corporation to bring suit, accomplish indirectly what it could not do directly. The applicable principle, the court stated, was first enunciated by Dean (then Commissioner) Roscoe Pound in the leading case of *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N.W. 1024 (1903), wherein he held that " 'If (shareholders) have no standing in equity to entitle them to the relief sought for their benefit, they cannot obtain such relief through the corporation or in its own name.' " (App. 36) The District Court stated that research had uncovered no case holding to the contrary (App. 39), and cited state and federal decisions denying corporate claims because shareholders had purchased their stock subsequent to the alleged wrongs. (App. 37-39)

On August 3, 1973 the Court of Appeals for the First Circuit reversed the District Court's decision. The First Circuit recognized that Amoskeag suffered no injury and did not question the general validity of the equitable principles applied below. (App. 57-58) It nonetheless reversed the District Court because BAR, the nominal plaintiff, was a railroad which the court termed a "public or a quasi-public corporation". (App. 61) The opinion stated that because of the nature of the services railroads provide, the public had an "identifiable interest" in their financial health and stated that this "public interest in the financial health of BAR provided a separate interest, quite apart from Amoskeag's, which was served by the corporate cause of action." (App. 60) Holding that the "separate interest" of the public permitted Amoskeag, through the instrument of the corporate plaintiffs, to bring a suit which would

* Such a suit, the court held, was barred both by the contemporaneous share ownership requirement written into FRCP 23.1 which was uncontradicted by Maine law, and the rule that a subsequent shareholder cannot sue where he acquired his stock from the alleged wrongdoer. (App. 34)

otherwise be barred, the First Circuit stated the basis of its decision as follows:

"We see BAR and its management as seeking a corporate recovery in which the public has a real, if inchoate interest. Amoskeag's windfall is irrelevant to that interest, and should not be the factor which determines whether or not BAR may sue." (App. 65)

Although the court below held that a presumed public benefit was the sole basis for permitting the suit to be maintained, the opinion conceded that it was doubtful the public would actually receive any benefits from a recovery by BAR. Specifically, the First Circuit recognized the obvious, that any recovery might be lawfully "syphon(ed) off . . . into the pockets of present shareholders" through a dividend distribution. (App. 66)

With respect to this possibility, the opinion could only suggest that the District Court might attempt to issue an order preventing distribution. It expressed doubt, however, that the District Court had the power to enter such an order, and specifically held that the ruling that plaintiffs could sue was not conditioned on the devising of any judicially imposed limitations on the uses of any recovery. (App. 66-67) The stated *raison d'être* of the action was thus recognized by the First Circuit to be unattainable.

Argument

I

The Decision Below Disregards the Fundamental Principle That a Litigant That Has Itself Suffered No Injury Lacks Standing to Bring an Action to Vindicate the Rights of the Public.

The *ratio decidendi* of the First Circuit's decision is that the action herein, although not maintainable as a strictly private action, is maintainable as an action to enforce the public's interest in the "financial health" of a railroad.

The Court asserted that the public has an "identifiable interest" in the financial ability of railroads to provide services and that this public interest provided "a separate interest, quite apart from Amoskeag's," served by the action. The Court viewed the plaintiffs before it as suing to protect this public interest, and on this basis held that equitable principles which otherwise would have barred the action were inapplicable. (App. 60)

Point II, *infra*, discusses the nature of the public's interest in railroads and demonstrates that the courts have never recognized a right in the general public to maintain an action of the type here presented. It is clear, however, that even if the public right assumed by the First Circuit did exist, Amoskeag would not have standing to assert it.

The starting point of any consideration of standing in the instant case is the undisputed fact that the real plaintiff and party in interest suffered no injury as a result of the acts upon which suit is brought. Having purchased its BAR stock after the alleged wrongs occurred, and having concededly received full value for its purchase price, the claims of Amoskeag here show not only no injury to a legally protected interest, but also no injury in fact.

This Court has recently greatly liberalized the law of standing in the context of suits to review governmental actions. In *Data Processing Service v. Camp*, 397 U.S. 150 (1970), and *Barlow v. Collins*, 397 U.S. 159 (1970), the Court replaced the "legal interest" test with a two-step inquiry involving a determination: (1) whether the plaintiff alleges injury in fact, economic or otherwise; and (2) if injury is alleged, whether the interest sought to be protected by the plaintiff is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question. The first step—the injury in fact test—was stated to be grounded in article III of the Constitution, which restricts federal jurisdiction to "cases and controversies." *Barlow v. Collins*, *supra*, at pp. 170-171 (Brennan, J., concurring).

Even in the context of the Administrative Procedure Act, 5 U.S.C. §§ 701 *et seq.*, however, which specifically provides for judicial review, this Court has insisted that the party seeking judicial intervention be himself among the injured before a federal court will take jurisdiction. In *Sierra Club v. Morton*, 405 U.S. 727 (1972), this Court drew a critical distinction between standing to bring an action and standing to assert the rights of the public once the action is properly initiated. To commence a proceeding, this Court there held, a litigant "must himself have suffered an injury." 405 U.S. at 738. The interests of the public can be argued only in support of the claim for relief; not to confer standing on a litigant who is himself uninjured. 405 U.S. at 737.

The decision below disregards the principles enunciated in *Sierra*. As in *Sierra*, a party that has itself suffered no injury, Amoskeag, has caused an action to be brought. Also as in *Sierra*, the lack of personal injury is sought to be remedied by assertions of an assumed public injury. The teaching of *Sierra*, however, is that any such assertions of the public interest may be heard only in support of claims of a party already properly in court. Injury to the public may not be used as a bootstrap to confer standing on a litigant otherwise barred from bringing suit.

The abandonment of the injury in fact test in the case at bar has much more serious implications than it would have had in *Sierra*. The number of persons who would wish to bring an environmental suit in which no monetary relief is sought is arguably limited; erosion of standing requirements for such actions might therefore have had a limited impact. The instant case, however, is a damage action, in which a court has accorded standing to an uninjured litigant to sue to obtain a \$7,000,000 windfall. Although the number of persons interested in bringing environmental suits may be limited, the number of persons interested in obtaining a \$7,000,000 windfall surely is not. The First Circuit's ero-

sion of standing requirements to bring damage actions invites a flood of new cases and litigants of unprecedented proportions.

The problems inherent in the abandonment of injury as a requisite of standing to bring damage actions go beyond judicial economy, however. Equitable relief is often indivisible, in that while a party may obtain equitable relief for himself, the relief necessarily benefits others as well. Where monetary recovery is sought, the situation is otherwise. If an uninjured party is given standing to bring a damage action for injuries to a third party, the effect is to give to one person a recovery that properly should go to others, or alternatively to permit double recovery. See *Hawaii v. Standard Oil Co.*, 405 U.S. 251, 261 (1972).

The instant case illustrates the point. The First Circuit's decision would permit Amoskeag, an uninjured party, to bring an action because of an alleged injury to the general public. The court below recognized, however, that Amoskeag might distribute any recovery to itself, thus preventing any application of the recovery for the benefit of the public. (App. 66) The most likely result of a litigation assertedly permitted to be maintained solely to benefit the public is no public benefit whatever.

Thus, Amoskeag does not meet a basic criterion that has been applied by this Court in determining questions of standing, viz.: whether "the party whose standing is challenged will adequately represent the interests he asserts." *Sierra Club v. Morton*, *supra*, at 758 (Blackmun, J., dissenting). Manifestly, Amoskeag, a private corporation whose duty to its shareholders requires it to make the maximum profit from BAR, cannot be an adequate representative of the public. If there is a public interest which can form a basis for the instant action, Amoskeag is not the proper entity to champion it.

The First Circuit brushed aside the inherent antagonism between Amoskeag and the public and the likelihood that the public would receive no benefit from any recovery by reference to a more general public interest which it saw as

served by the litigation. Referring to this Court's decisions in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), and *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968), the opinion stated that the acts complained of "were so clearly violative of state and federal policies . . . as to invite the encouragement of private lawsuits as a supplement to public enforcement." (App. 65)

It is respectfully submitted that nothing in *Borak* or *Perma Life* sanctions the decision reached by the First Circuit. In *Borak*, this Court implied a private right of action in favor of a plaintiff who unquestionably alleged injury and was clearly the object of statutory protection. Similarly, in *Perma Life* this Court again held that a plaintiff who was unquestionably injured should not be barred from suing for damages by a *pari delicto* defense. In both cases, the private litigation which was seen as a supplement to public enforcement was litigation by a party who was actually injured.

The decision below enunciates a different doctrine. In the interest of supplementing public enforcement, the First Circuit would permit anyone, whether injured or not, to bring suit, the sole criterion being the willingness of the party to bring suit, "whoever it may be and whatever its private aims." (App. 65) In effect, the holding eliminates all standing requirements in suits which arguably supplement public enforcement.

Whether as a matter of constitutional limitation or judicial self-restraint, this court has consistently held that injury is the touchstone of standing. Just last term this Court stated that changes in the law of standing over the past ten years have not altered the requirement that "at least in the absence of a statute expressly conferring standing, federal plaintiffs must allege some threatened or actual injury before a federal court may assume jurisdiction." *Linda R. S. v. Richard D.*, 410 U.S. 614, 617 (1973). The Court reiterated the principle this term in *O'Shea v. Littleton*, 42 U.S.L.W. 4139, 4141 (U.S. Sup. Ct. January 15, 1974),

where it stated that the requisite personal injury must be "real" and "direct," and could not be "conjectural," "hypothetical" or "abstract."

The decision below is contrary to the foregoing principle, and disregards all prior precedents in the federal courts.* Unless fundamental limitations on federal standing heretofore uniformly imposed are to be disregarded, the decision must be reversed and the judgment of the District Court reinstated.

II.

The Decision Below Creates a New Public Right of Action Unsanctioned by Common Law or Statute and Based on a Totally Speculative Injury.

As pointed out in the Statement of the Case, *supra*, the First Circuit agreed with the District Court that Amoskeag had no interest of its own which would justify maintenance of the action (App. 59-60). The holding of the First Circuit was that it was the public's interest in the financial health of the railroad, described as a "separate interest, quite apart from Amoskeag's" (App. 60), that permitted the action to be maintained. The Court below saw this public interest as an independent basis for the action, and Amoskeag as an appropriate champion of it.

The foregoing holding — that a presumed public interest in the financial health of "public" or "quasi-public" corporations provides a basis for maintenance of a private damage action — has far reaching implications. In this case the First Circuit permitted Amoskeag to champion the presumed public interest, but the rationale that here permits Amoskeag to sue requires recognition of the right of

* Professor Kenneth Davis, a leading commentator on standing has written:

"Even though the past law of standing is so cluttered and confused that almost every proposition has some exception, the federal courts have consistently adhered to one major proposition without exception: One who has no interest of his own at stake always lacks standing." K. Davis, *Administrative Law Text* pp. 428-429 (3d ed. 1972.)

a member of the general public to institute suit directly. If the First Circuit is correct that the public has a legally protected interest in the financial health of a railroad, federal courts must entertain suits brought directly by the protected class to enforce its rights. *Cf. Bivens v. Six Unknown Narcotics Agents*, 403 U.S. 388 (1971); *J. I. Case v. Borak*, *supra*. A substantial public right cannot depend for its vindication on the willingness of private shareholders or corporate management—groups normally antagonistic to the public—to bring suit.

The decision has particularly broad implications because of the statutes involved. Plaintiffs claim in the first instance for corporate waste and mismanagement, but they also seek recovery under the Clayton Act and the Securities Exchange Act of 1934. In recognizing the public interest as a basis for suit in the instant case, the First Circuit has necessarily opened the way for damage actions by the public *qua* public under the federal antitrust and securities laws, as well as the common law.

No precedent for the action is found in the common law. Management and directors of a corporation are answerable under the common law only to the corporation's shareholders, and only the corporation or its shareholders have the right to bring an action to indemnify the corporation for corporate waste and mismanagement. The derivative action, which is the instrument developed by the common law to protect shareholders, may only be brought by shareholders, and it specifically contemplates an action for injury to their interests, not those of the public. H. HENS, *LAW OF CORPORATIONS* § 358 (2nd ed. 1970).

Similarly, no precedent for the instant action can be found in the federal antitrust or securities statutes under which Plaintiff-respondents sue. With respect to the antitrust laws, the courts have uniformly held that only those who are the direct targets of violations, or who have been directly harmed thereby, may recover. *See Commonwealth Edison Co. v. Allis-Chalmers Mfg. Co.*, 315 F.2d 564 (7th Cir. 1963), *cert. denied sub nom. Illinois v. Commonwealth Edison Co.*, 375 U.S. 385 (1963); *Productive Inventions*,

Inc. v. Trico Products Corp. 224 F.2d 678, 679 (2nd Cir. 1955), *cert. denied*, 350 U.S. 936 (1956); *Billy Baxter, Inc. v. Coca-Cola Co.*, 431 F.2d 183, 187-88 (2nd Cir. 1970), *cert. denied*, 401 U.S. 923 (1971); *Calderone Enterprises Corp. v. United Artists Theatre Circuit*, 454 F.2d 1292, 1295 (2nd Cir. 1971), *cert. denied*, 406 U.S. 930 (1972). Under the federal securities laws and SEC Rule 10b-5, only defrauded purchasers or sellers of securities, or at the most persons who can show injury in their capacity as investors, have been allowed to recover for violations of those laws. *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971); *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2nd Cir. 1952), *cert. denied*, 343 U.S. 956 (1952); *Iroquois Industries, Inc. v. Syracuse China Corp.*, 417 F.2d 963 (2nd Cir. 1969), *cert. denied*, 399 U.S. 909 (1970); *Herpich v. Wallace*, 430 F.2d 792 (5th Cir. 1970); *Kahan v. Rosenstiel*, 424 F.2d 161 (3d Cir. 1970), *cert. denied sub nom. Glen Alden Corp. v. Kahan*, 398 U.S. 950 (1970); *Simmons v. Wolfson*, 428 F.2d 455 (6th Cir. 1970), *cert. denied*, 400 U.S. 999 (1971); *Eason v. General Motors Acceptance Corp.*, C.C.H. Fed. Sec. L. Rep. (Current Transfer Binder) ¶94, 344 (7th Cir. 1973).

The First Circuit's opinion does more than ignore the foregoing authorities, which limit the injuries legally cognizable under the federal anti-trust and securities statutes. It has dispensed completely with the concept of injury, endowing the general public with an enforceable legal claim predicated solely on the presence of an alleged "inchoate interest" in BAR's financial health.*

* Elimination of injury as a predicate was necessitated by the absence of any demonstration or theoretical exposition of injury to the public from the wrongs alleged. By the same token, had there been injury to a member of the general public cognizable under common law or statute, the novel doctrine enunciated by the court would have been unnecessary to protect his interest. As this Court pointed out in *Hawaii v. Standard Oil*, *supra*, citizens with cognizable injuries could sue individually or, using the procedures provided under F.R.C.P. 23, bring a class action. 405 U.S. at 266. Indeed, if there were cognizable injuries to the public, the First Circuit's decision permitting BAR to bring suit would open the way to the double recovery rejected by *Hawaii*.

The First Circuit's radical expansion of the allowable causes of action under the foregoing statutes and recognition of a new private right of action on behalf of the public was done without reference to either of the statutes, the common law, or even the Maine Public Utilities Act. Support was found instead in: (1) a presumed status of railroads as " 'public' or 'quasi-public' corporations" (App. 61); (2) Congress' recognition of the public importance of rail carriers in enacting the Transportation Act of 1920, and Section 77 of Chapter VIII of the Bankruptcy Act (App. 63); (3) expressions of concern by the ICC that the reorganization of certain railroads (not including the BAR) under Section 77 of the Bankruptcy Act "create implications of nationwide importance" (App. 64); and (4) dictum in an opinion by the Maine Supreme Judicial Court that, as of fourteen years ago, rail freight service was crucially important to the Maine economy. (App. 64-65)

It may readily be conceded that railroads are in a business affecting the public interest. Airlines, trucking companies and other common carriers affect the public interest in a similar manner and to as great a degree. So too do industrial concerns such as U.S. Steel, Boeing Aircraft, General Motors, Gulf Oil and Exxon, on whose financial health the entire economy of large communities and, indeed, the nation may depend. If the importance of a business to the public is to be sufficient grounds to recognize suits by and on behalf of the public, virtually all major corporations in the United States will be subject to such suits.

The question, however, is not the importance of railroads to the public nor the financial difficulties of many railroads today.* The right to judicial relief, as Justice Frankfurter pointed out in another context, depends upon the existence of a common law right or an interest created

* It should be noted that no allegation was made in the complaint that BAR was in any financial difficulty.

by the Constitution or statute. See *Joint Anti-Fascist Refugee Committee v. McGrath*, 341 U.S. 123, 152. The question, therefore, is whether the common law or statutes have created the cause of action sued upon. Having cited none, the First Circuit was required to affirm the District Court's dismissal of the action. See *National Railroad Passenger Corp. v. National Association of Railroad Passengers*, No. 72-1289 (U.S. Sup. Ct. January 9, 1974).

Beyond the lack of a statutory or common law basis, the opinion below ignored the fact that the public interest in railroads is already protected by extensive government regulation which provides specific and limited remedies. Under Part I of the Interstate Commerce Act, 49 U.S.C. §§ 1-27, a carrier must obtain Interstate Commerce Commission approval before it extends or abandons any rail lines, 49 U.S.C. § 1(18); combines, consolidates or merges with any other carrier, 49 U.S.C. § 5(2)(a); or issues any capital stock or bond, 49 U.S.C. § 20a(2). The Act also gives the Commission the power to determine reasonable rates and charges, 49 U.S.C. § 15(1); to establish rules respecting the use of railroad cars, 49 U.S.C. § 1(14); and to require any carrier to provide adequate and safe facilities or to extend its lines in the public interest, 49 U.S.C. § 1(21). Further, the Act creates private causes of action for damages incurred by reason of acts specifically prohibited by statute. 49 U.S.C. § 8; *Atlantic Coast Line v. Riverside Mills*, 219 U.S. 186, 207-8 (1911). In addition, comparable regulation and private rights of action are provided for under the Maine Public Utilities Act.

Prior to the instant case, federal courts have deferred to Congress' regulatory scheme and have refused to create remedies that Congress withheld. Thus this Court rejected proposals that it create new private rights of action not specifically created by the statute in *T.I.M.E. Inc. v. United States*, 359 U.S. 464, 475 (1958). Cf. *Montana Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S.

246, 254-5 (1951); *National Railroad Passenger Corp. v. National Association of Railroad Passengers*, *supra*. Lower courts have followed the same rule, refusing to imply private remedies against railroads beyond those enumerated in the Act. *S. H. & W. Lumber Co. v. California & Oregon Coast R. R.*, 154 F. Supp. 152 (D. Oregon 1957); *Asbury v. Chesapeake & Ohio Ry.*, 314 F. Supp. 310 (D.D.C. 1970); *National Railroad Passenger Corp. v. National Association of Railroad Passengers*, *supra*. The opinion below disregards these precedents.

An additional and even more fundamental fact bars creation in the instant case of a right of action premised on public injury. Nowhere in the pleadings or papers before either court below was any injury to the public alleged or specified.* The First Circuit's assumption that the acts complained of caused public injury was pure speculation, with no foundation in the record.

As pointed out in Point I, *supra*, this Court has held that conjectural or theoretical injury is insufficient to meet the constitutional requirement that those who seek to invoke the power of the federal courts must allege an actual case or controversy. *O'Shea v. Littleton*, *supra*. The requirement is met, the Court stated in *O'Shea*, only if the injury is "real and direct;" generalized allegations of "hypothetical" or "abstract" injury are insufficient. *O'Shea v. Littleton*, *id.*, at 4141.

Manifestly, the injury upon which the First Circuit premised its decision does not meet the constitutional requirements. The record is devoid of any claim of public injury, and the First Circuit's opinion itself fails to specify any public harm from the acts upon which suit is brought. On such a record, the standards laid down by this court in *O'Shea v. Littleton*, *supra*, and *Linda R.S. v. Richard D.*, *supra*, require dismissal of the action.

* Nor was the point briefed or argued.

III.

The Court of Appeals Rejected a Universally Recognized Principle Correctly Applied by The District Court.

In dismissing the instant case, the District Court followed a universally applied principle. For over seventy years, courts considering whether a corporation may maintain an action of the type here presented have looked behind the corporate form to the shareholders who would benefit from a corporate recovery. Where the shareholder had no standing to demand the relief sought from the corporation, the action has been dismissed.

The foregoing rule was first enunciated by Dean (then Commissioner) Roscoe Pound in the leading case of *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N.W. 1024 (1903). In *Home Fire*, Dean Pound stated that in an action for corporate waste and mismanagement, the corporation had standing only as the representative of its shareholders, and held that in such an action the court must look behind the corporate form and determine whether the shareholders, the real beneficiaries, had standing to demand the relief sought. Applying the Rule, Dean Pound held that the fact that the corporation's existing shareholders had acquired their stock after the acts complained of barred the corporate claims for waste and mismanagement because a contrary result would permit the shareholders to recover monies to which they had no claim. (67 Neb. at 662-63, 93 N.W. at 1031)

The *Home Fire* case recognized two fundamental realities: (1) any injury done to a corporation through waste and mismanagement injures the stockholders who own shares at the time of the wrong, not those who purchased their shares subsequently; and (2) if stockholders, who owned no shares at the time of the acts of corporate mismanagement and waste are allowed to bring suit on such claims, the result will be the unjust enrichment of persons who suffered no injury.

The *Home Fire* rule has been followed by federal courts. In *Amen v. Black*, 234 F.2d 12 (10th Cir. 1956), a case remarkably similar to the one at bar, a corporation, through its receivers, asserted claims for recovery of the profits allegedly realized by Black, its former president, from the improper use of company funds and from the sale of corporate stock wrongfully obtained from the corporation. The court denied relief to the corporation, holding:

"Looking at the substance of the corporate claims and the beneficiaries thereof, it becomes readily apparent that the principal beneficiary of any recovery on behalf of the corporation would be the N.C.R.A. who became the principal stockholder upon the purchase of a majority of the stock in 1947. And having purchased the stock of the corporation from Black in an arms length transaction, and having received the full value of its purchase, any recovery as stockholder beneficiary of the dissolved corporation would be tantamount to recoupment of the legitimate purchase price of the stock. Obviously there are no equities in such a result, and we therefore hold that the corporate claims must fail for lack of standing to maintain the suit and for want of equity on the part of the beneficiaries in any corporate recovery." 234 F. 2d at 23.

The rule has also been followed by every state court confronted by the question. In each case, the court dismissed the suit because it recognized that prosecution could only result in windfall profits to shareholders that had suffered no injury. *Park Terrace, Inc. v. Burge*, 249 N.C. 308, 106 S.E.2d 478 (1959); *Mathews v. Fort Valley Cotton Mills*, 179 Ga. 580, 176 S.E. 505 (1934); *State Trust & Savings Bank v. Hermosa Land & Cattle Co.*, 30 N.M. 566, 240 P. 469 (1925); *Pueblo Foundry & Machine Co. v. Lannon*, 68 Colo. 131, 187 P. 1031 (1920); *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 A. 645 (1917); *First State Bank v. Morton*, 146 Ky. 287, 142 S.W. 694 (1912).

The reasons the rule has been so uniformly followed are easily discernible. In addition to giving effect to the basic equitable principle that courts should not be an instrument for unjust enrichment, the rule also furthers the policy of confining litigation to cases where the claimants are truly aggrieved. In this regard, the rule follows and is consistent with a policy underlying the contemporaneous share ownership requirement of Federal Rule of Civil Procedure 23.1 that federal courts will not permit themselves to be used to litigate a purchased grievance. *Cohen v. Beneficial Loan Corp.*, 337 U.S. 541, 556 (1949).

Faced with the foregoing distinguished and pervasive precedents, the First Circuit did not frontally attack the rule. Agreeing that it was generally applicable, the court held that it did not apply to the instant action because of the nature of BAR's business. The court, in effect, created an exception to the rule, viz: that it is inapplicable where the nominal plaintiff is a corporation whose business affects the public welfare.

The exception created by the First Circuit has no precedents. It is unnecessary to go beyond the instant case to understand why this is so. It is undisputed that any corporate recovery in this action will principally benefit Amoskeag, an uninjured shareholder. Yet that is precisely the result the rule was designed to prevent. The First Circuit's exception is inconsistent with the *raison d'être* of the rule.

Indeed, it is inconsistent with the court's own opinion. The premise of the First Circuit's exception was an assumption that a public benefit in the form of better service would result from the recovery. However, the court refused to condition its ruling on the fulfillment of this premise. Conceding that it probably lacked power to prevent Amoskeag from distributing any corporate recovery to itself, thus preventing any benefit to the public, the Court specifically stated that its decision did not depend upon the devising of court imposed limitations to prevent such a

distribution. (App. 66-67) Doubtless, just such difficulties have deterred other courts from formulating the exception the First Circuit enunciated.

The decision below does more than eviscerate a hitherto universally accepted rule and principle, however. It also throws into question the continued efficacy of the contemporaneous share ownership requirement of Rule 23.1 of the Federal Rules of Civil Procedure. By its terms, Rule 23.1 would bar a shareholder action brought directly by Amoskeag, since Amoskeag cannot allege that it was a shareholder at the time the alleged illegal acts occurred. The First Circuit's decision permits Amoskeag and other litigants to evade the Rule's restrictions by the simple device of causing the action to be brought in the corporate name.

Such a result conflicts with prior decisions of this Court which have consistently held that federal jurisdictional limitations cannot be evaded by use of a nominal plaintiff. On this principle, this Court has dismissed actions nominally brought by states where examination of the record disclosed that the real parties in interest were citizens barred from bringing suit by the eleventh amendment. *New Hampshire v. Louisiana*, 108 U.S. 76, 88-9 (1883); *Poindexter v. Greenhow*, 114 U.S. 270, 287 (1885); *In re Ayers*, 123 U.S. 443, 490 (1887). On the same principle, this Court has dismissed actions nominally brought by corporations where the real parties in interest were individuals barred by the diversity requirements of article III of the Constitution. *Miller & Lux v. East Side Canal Co.*, 211 U.S. 293 (1908); *Southern Realty Co. v. Walker*, 211 U.S. 603 (1909). The doctrine enunciated by these cases is that access to the federal courts is to be governed by the identity of the real parties in interest, rather than the parties of record.

The First Circuit ignored this principle in permitting Amoskeag to bring an action otherwise barred through the device of utilizing the corporation as the party of

record. The decision below thus not only negates the universally accepted *Home Fire* rule, but disregards basic doctrine that previously has governed all questions of access to the federal courts.

Conclusion

The order of the Court of Appeals for the First Circuit should be reversed, and the order of the District Court for the District of Maine reinstated.

Respectfully submitted,

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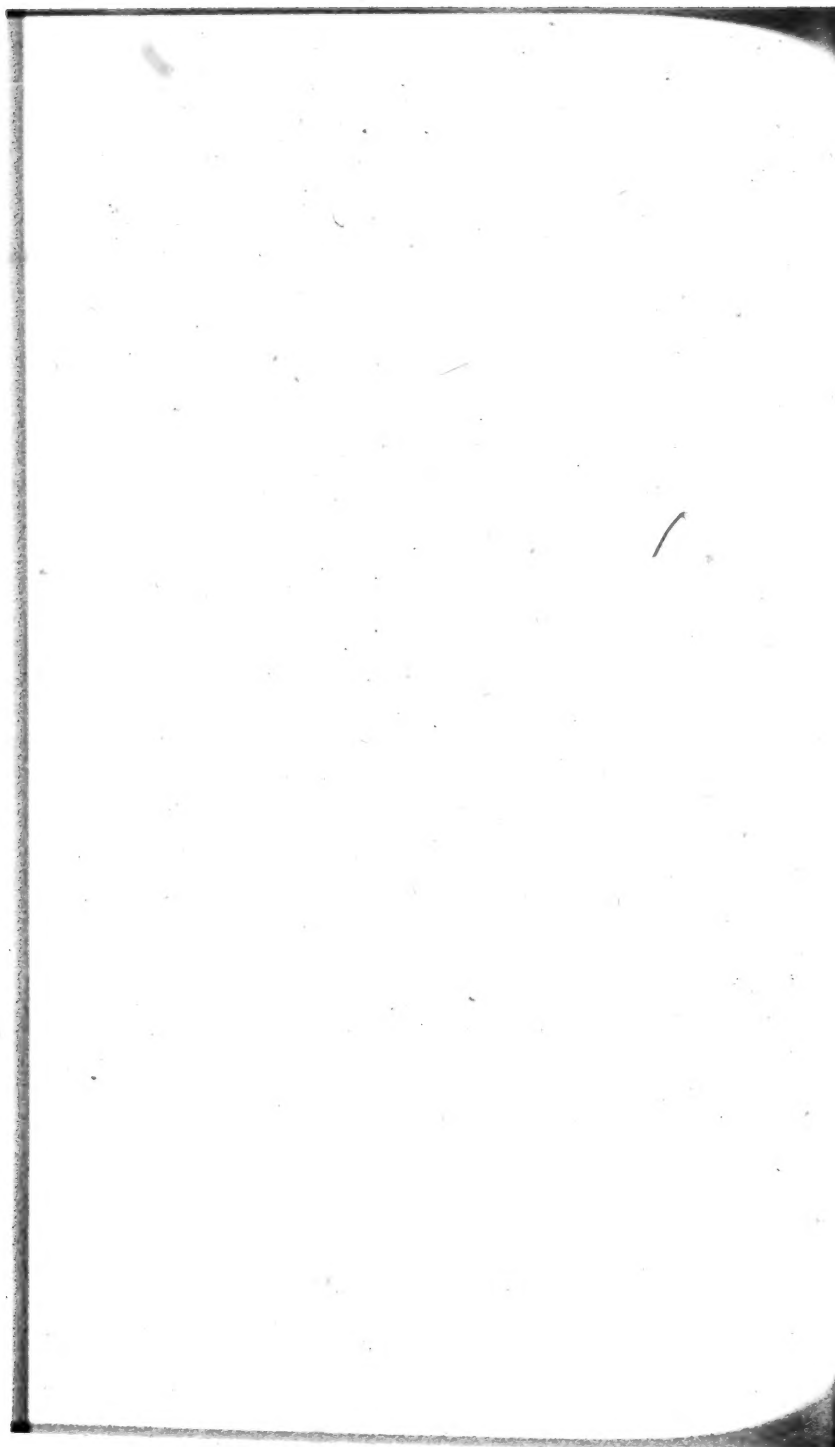
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APPENDIX



Statutes and Regulations Involved

1. United States Constitution art. III § 2 reads in pertinent part as follows:

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority;—to all Cases affecting Ambassadors, other public Ministers and Consuls;—to all Cases of admiralty and maritime Jurisdiction;—to Controversies to which the United States shall be a Party;—to Controversies between two or more States;—between a State and Citizens of another State;—between Citizens of different States,—between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

2. United States Constitution amend. XI reads as follows:

The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

3. Clayton Act § 10, 15 U.S.C. § 20, reads in pertinent part as follows:

No common carrier engaged in commerce shall have any dealings in securities, supplies, or other articles of commerce, or shall make or have any contracts for construction or maintenance of any kind, to the amount of more than \$50,000, in the aggregate, in any one year, with another corporation, firm, partnership, or association when the said common carrier shall have upon its board of directors or as its president, manager, or as its purchasing or selling officer, or agent in the particular transaction, any person who is at the same time a director, manager, or purchasing or selling officer of, or who has any substantial interest in, such

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other corporation, firm, partnership, or association, unless and except such purchases shall be made from, or such dealings shall be with, the bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding under regulations to be prescribed by rule or otherwise by the Interstate Commerce Commission. No bid shall be received unless the name and address of the bidder or the names and addresses of the officers, directors, and general managers thereof, if the bidder be a corporation, or of the members, if it be a partnership or firm, be given with the bid.

4. Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b), reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

5. SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

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(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

6. Interstate Commerce Act, Part I, § 1(14), 49 U.S.C. § 1(14), reads in pertinent part as follows:

(a) The Commission may, after hearing, on a complaint or upon its own initiative without complaint, establish reasonable rules, regulations, and practices with respect to car service by common carriers by railroad subject to this chapter, including the compensation to be paid and other terms of any contract, agreement, or arrangement for the use of any locomotive, car, or other vehicle not owned by the carrier using it (and whether or not owned by another carrier), and the penalties or other sanctions for nonobservance of such rules, regulations, or practices. * * *

7. Interstate Commerce Act, Part I, § 1(18), 49 U.S.C. § 1(18), reads as follows:

No carrier by railroad subject to this chapter shall undertake the extension of its line of railroad, or the construction of a new line of railroad, or shall acquire or operate any line of railroad, or extension thereof, or shall engage in transportation under this chapter over or by means of such additional or extended line of railroad, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or

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construction and operation, of such additional or extended line of railroad, and no carrier by railroad subject to this chapter shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment. Nothing in this paragraph or in section 5 of this title shall be considered to prohibit the making of contracts between carriers by railroad subject to this chapter, without the approval of the Commission, for the joint ownership or joint use of spur, industrial, team, switching, or side tracks.

8. Interstate Commerce Act, Part I, § 1(21), 49 U.S.C. § 1(21), reads as follows:

The Commission may, after hearing, in a proceeding upon complaint or upon its own initiative without complaint, authorize or require by order any carrier by railroad subject to this chapter, party to such proceeding, to provide itself with safe and adequate facilities for performing as a common carrier its car service as that term is used in this chapter, and to extend its line or lines: * * *

9. Interstate Commerce Act, Part I, § 5(2)(a), 49 U.S.C. § 5(2)(a), reads as follows:

It shall be lawful, with the approval and authorization of the Commission, as provided in subdivision (b) of this paragraph—

(i) for two or more carriers to consolidate or merge their properties or franchises, or any part thereof, into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership; or for any carrier, or two or more carriers jointly, to purchase, lease, or contract

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to operate the properties, or any part thereof, of another; or for any carrier, or two or more carriers jointly, to acquire control of another through ownership of its stock or otherwise; or for a person which is not a carrier to acquire control of two or more carriers through ownership of their stock or otherwise; or for a person which is not a carrier and which has control of one or more carriers to acquire control of another carrier through ownership of its stock or otherwise; or

(ii) for a carrier by railroad to acquire trackage rights over, or joint ownership in or joint use of, any railroad line or lines owned or operated by any other such carrier, and terminals incidental thereto.

10. Interstate Commerce Act, Part I, § 8, 49 U.S.C. § 8 reads as follows:

In case any common carrier subject to the provisions of this chapter shall do, cause to be done, or permit to be done any act, matter, or thing in this chapter prohibited or declared to be unlawful, or shall omit to do any act, matter, or thing in this chapter required to be done, such common carrier shall be liable to the person or persons injured thereby for the full amount of damages sustained in consequence of any such violation of the provisions of this chapter, together with a reasonable counsel or attorney's fee, to be fixed by the court in every case of recovery, which attorney's fee shall be taxed and collected as part of the costs in the case.

11. Interstate Commerce Act, Part I, § 15(1), 49 U.S.C. § 15(1), reads as follows:

Whenever, after full hearing, upon a complaint made as provided in section 13 of this title, or after full hearing under an order for investigation and hearing made by the Commission on its own initiative,

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either in extension of any pending complaint or without any complaint whatever, the Commission shall be of opinion that any individual or joint rate, fare, or charge whatsoever demanded, charged, or collected by any common carrier or carriers subject to this chapter for the transportation of persons or property, as defined in section 1 of this title, or that any individual or joint classification, regulation, or practice whatsoever of such carrier or carriers subject to the provisions of this chapter, is or will be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial, or otherwise in violation of any of the provisions of this chapter, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable individual or joint rate, fare, or charge, or rates, fares, or charges, to be thereafter observed in such case, or the maximum or minimum, or maximum and minimum, to be charged, and what individual or joint classification, regulation, or practice is or will be just, fair, and reasonable, to be thereafter followed, and to make an order that the carrier or carriers shall cease and desist from such violation to the extent to which the Commission finds that the same does or will exist, and shall not thereafter publish, demand, or collect any rate, fare, or charge for such transportation other than the rate, fare, or charge so prescribed, or in excess of the maximum or less than the minimum so prescribed, as the case may be, and shall adopt the classification and shall conform to and observe the regulation of practice so prescribed.

12. Interstate Commerce Act, Part I, § 20a(2), 49 U.S.C. § 20a(2), reads as follows:

It shall be unlawful for any carrier to issue any share of capital stock or any bond or other evidence of

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interest in or indebtedness of the carrier (hereinafter in this section collectively termed "securities") or to assume any obligation or liability as lessor, lessee, guarantor, indorser, surety, or otherwise, in respect of the securities of any other person, natural or artificial, even though permitted by the authority creating the carrier corporation, unless and until, and then only to the extent that, upon application by the carrier, and after investigation by the commission of the purposes and uses of the proposed issue and the proceeds thereof, or of the proposed assumption of obligation or liability in respect of the securities of any other person, natural or artificial, the commission by order authorizes such issue or assumption. The commission shall make such order only if it finds that such issue or assumption: (a) is for some lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose: *Provided*, That nothing in this section is to be construed as applying to securities issued or obligations or liabilities assumed by the United States or any instrumentality thereof, or by the District of Columbia or any instrumentality thereof, or by any State of the United States, or by any political subdivision or municipal corporation of any State, or by any instrumentality of one or more States, political subdivisions thereof, or municipal corporations.

13. Maine Public Utilities Act § 104, 35 M.R.S.A. § 104, reads as follows:

No public utility doing business in this State shall extend credit or make loans to or make any contract or arrangement, providing for the furnishing of manage-

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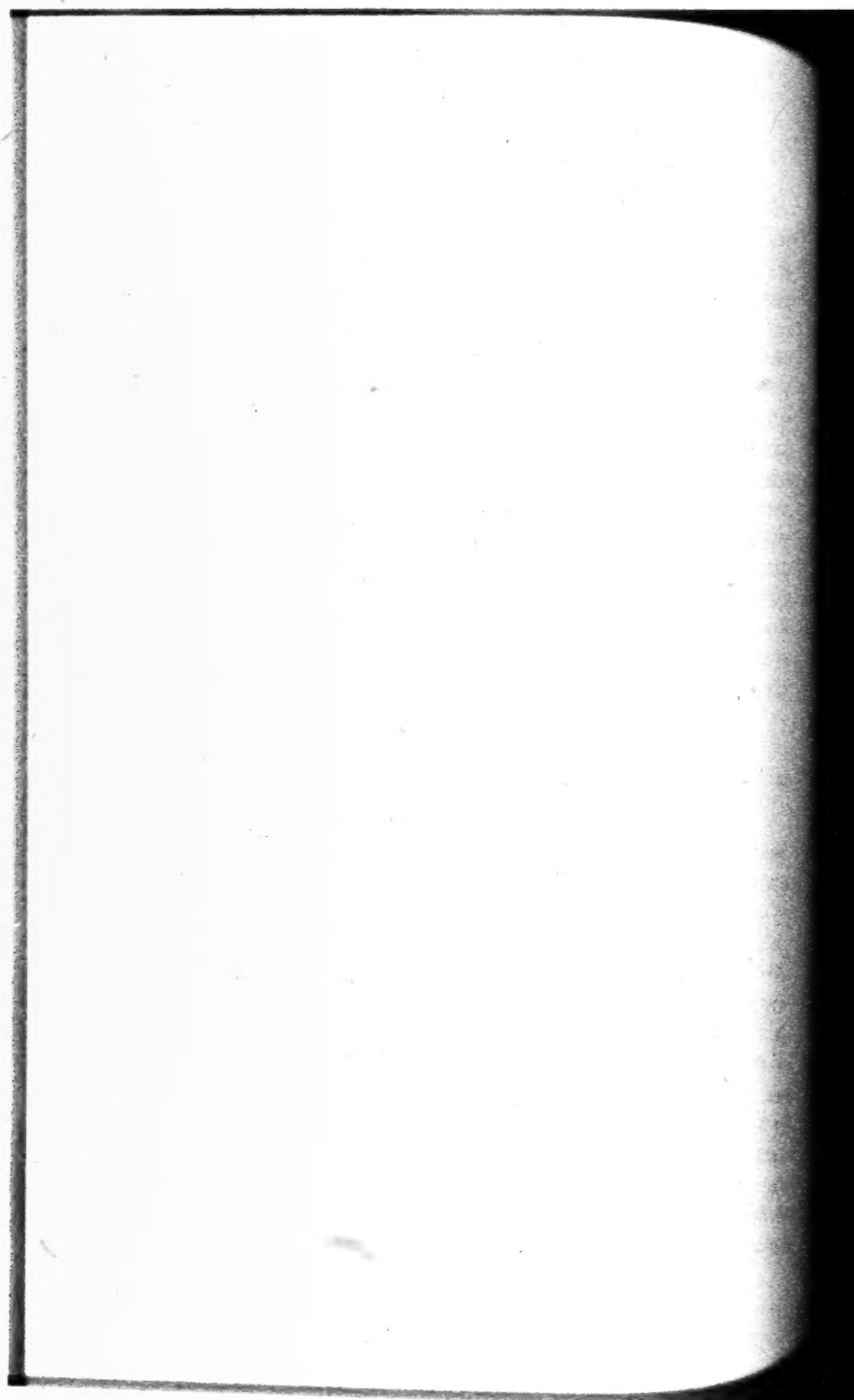
ment, supervision of construction, engineering, accounting, legal, financial or similar services, or for the furnishing of any service other than those enumerated, with any corporation, person, partnership or trust, holding, controlling or owning in excess of 25% of the voting capital stock of such public utility, or with any other corporation which is itself owned or controlled by or affiliated with any corporation, person, partnership or trust, holding, controlling or owning a majority of the voting capital stock of such public utility, unless and until such contract or arrangement shall have been found by the commission not to be adverse to the public interest and shall have received their written approval. The commission shall in the case of any utility have the power to exempt herefrom, from time to time, such classes of transactions as it may specify in writing in advance and which in its judgment will not affect the public interest.

14. Federal Rule of Civil Procedure 23.1 reads as follows:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or com-

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parable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.



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In the
Supreme Court of the United States
OCTOBER TERM, 1973

No. 73-718

BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,
Petitioners,

v.

BANGOR & AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENTS

QUESTIONS PRESENTED

1. May the Railroad sue in its own name and behalf to recover damages for assets which its former majority stockholder divested from it in violation of federal and state law?
2. Have the Railroad and its subsidiary standing to sue where they have been injured by acts of the Petitioners that constitute (i) conversion at common law (ii) violations of the Clayton Act and (iii) violations of SEC Rule 10b-5?

3. Is the Railroad to be denied a remedy because its present majority stockholder may enjoy a benefit therefrom?

STATUTES AND REGULATIONS INVOLVED

In addition to the statutes and regulations mentioned in the Petitioners' brief, there are involved Section 4 of the Clayton Act, 15 U.S.C. § 15; Section 2072 of the Judiciary Code, 28 U.S.C. § 2072; Sections 5(2) and 13a of the Interstate Commerce Act, 49 U.S.C. §§ 5(2) and 13a; and Section 15 of the Maine Public Utilities Act, 35 M.R.S.A. § 15.

The text of these statutes is set out in Appendix A to this brief.

STATEMENT OF THE CASE

This action is brought by the Bangor and Aroostook Railroad Company (Railroad) and its wholly-owned subsidiary, Bangor Investment Company (BIC), against Bangor Punta Corporation (BP) and its wholly-owned subsidiary, Bangor Punta Operations (BPO). The Railroad is a Maine corporation organized in 1891. (A.1-2) It provides essential services for those persons and businesses located in the northern half of Maine. (A.2) Its Comparative General Balance Sheet as contained in the Railroad Annual Report, Form A, for the year ending December 31, 1972, as filed with the Interstate Commerce Commission, shows assets of \$67,726,890.

This suit was authorized by vote of the Railroad's Board of Directors. (A.46-7) In July of 1971 (A.6) there had been made public a Report¹ (ICC Report) to the Interstate Com-

¹ The Report is set out in Appendix B to this brief. Judicial notice may be taken of it. *Arizona v. California*, 283 U.S. 423, 454 (1931). See the order of the court of appeals. (A.53)

merce Commission (Commission) prepared by the Bureau of Accounts of the Commission, entitled "Review of Diversified Holding Company Relationships and Transactions of Bangor Punta Corporation." The ICC Report stated:

"The purpose of the review was to explore the impact of the Bangor Punta Corporation on the Bangor and Aroostook Railroad while it was owned by and under the control of this diversified holding company and to determine whether or not the intercompany relationships and resulting financial transactions were detrimental to the carrier." (p. 45, *infra*)

The ICC Report included a recommendation:

"We recommend that all legal remedies be explored to require the holding company, which sold the carrier, to pay back to the carrier for assets taken with no compensation and charges made where no services were performed." (p. 46, *infra*)

The ICC Report was discussed at a meeting of the Railroad's Board held on July 29, 1971. (A.44-5) Since some of the directors were not then familiar with it, no formal action was taken. On August 26, 1971, copies were mailed to all directors. (A.45) At a meeting held December 8, 1971, the Railroad's outside counsel discussed, "paragraph by paragraph", a draft complaint explaining the legal basis of the various claims contained therein. (A.46) It was unanimously voted to authorize the Railroad's Chief Executive Officer, upon advice of counsel, to commence and conduct litigation. (A.46-7)

The Claims Asserted

The original complaint was filed in the U. S. District Court for the District of Maine on December 30, 1971, (A.ii)

and an amended complaint was filed on August 18, 1972.
(A.iii) It is alleged,

“The causes of action asserted in this Amended Complaint belong to [the Railroad] and are asserted directly by it.” (A.5)

Both complaints contained thirteen counts asserting violations of Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5; Section 10 of the Clayton Act, 15 U.S.C. § 20; Section 104 of the Maine Public Utilities Act, 35 M.R.S.A. § 104; and the Maine common law. As examples, the facts underlying one count under each theory are set out here.

1) Rule 10b-5

Count VI (A.14-5) alleges that in September 1962 BIC owned 67,789 shares of stock in the St. Croix Paper Company, worth in excess of \$2,000,000. The Bangor and Aroostook Corporation (BAC), the predecessor holding company of BP and BPO (A.4), learned from inside sources that the Georgia Pacific Corporation was negotiating with St. Croix to make a tender offer to St. Croix stockholders. Before this information became public and without disclosing it to either the Railroad or BIC, BAC caused the Railroad and BIC to enter into a three-way agreement whereby all 67,789 shares of St. Croix stock were transferred to BAC. As a result, the Railroad and BIC suffered damages of approximately \$1,500,000, which is the profit that BAC made on the exchange of St. Croix stock for Georgia Pacific stock, which occurred shortly thereafter, and the subsequent appreciation of Georgia Pacific stock.

2) Section 10 of the Clayton Act

Count IV (A.13) alleges that in September 1962 BAR and BAC had nine overlapping directors. As part of the three-

way transaction involving the St. Croix stock, described above, some \$1,018,000 par value of BAC preferred stock was transferred to the Railroad at its par value of \$100 per share, without satisfying the bidding requirements of Section 10 of the Clayton Act. The fair market value of the preferred stock was substantially less than the par and than the fair market value of the St. Croix stock.

3) Maine Public Utilities Laws: 35 M.R.S.A. § 104

Count II (A.9-10) alleges that from 1962 through 1967 first BAC and then its successor BPO, while owning in excess of 97% of the Railroad's voting stock, billed the Railroad for "corporate charges" and received payments aggregating \$810,000. None of these contracts, arrangements or payments for alleged legal, accounting and printing services was submitted to the Maine Public Utilities Commission for approval as required by Section 104, and, in fact, these arrangements were adverse to the public interest and would have been disapproved if submitted, because virtually none of these services was performed for the Railroad.² (A.8-9)

4) Maine Common Law: Conversion

Count I (A.8-9) alleges that \$810,000 was paid to BAC and BPO for nothing but nominal services and was authorized by officers and directors who at the time were also officers and directors of BAC or BPO, had conflicting loyalties and placed the interests and welfare of BAC and BPO ahead of the Railroad. These payments amount to conversion and misappropriation of assets.

² Under Maine law railroads are public utilities. 35 M.R.S.A. § 15, set out in Appendix A to this brief. Section 104 is set out in the Petitioners' Brief at A-7.

Further Facts

Approximately 99% of the Railroad's stock is now owned by the Amoskeag Company (Amoskeag), a diversified operating company, registered under the Securities Exchange Act of 1934, with its stock publicly held and traded.³ Amoskeag purchased in excess of 98% of the Railroad's stock from BP and BPO on October 2, 1969 and has acquired another 1% in miscellaneous small transactions since that time. It is alleged that the domination and control of the Railroad by BP, BPO and their predecessor, BAC, "resulted in fraudulent concealment of the systematic exploitation of [the Railroad] and, further, prevented any effective investigation being made of such exploitation and the commencement of any suit with respect thereto until after [the Railroad] was sold in 1969". (A.5)

In addition to Amoskeag, there are presently twenty-two stockholders in the Railroad. (A.6-7, 22-3) Twelve of these acquired their stock prior to 1960. (A.6-7, 22-3) The Railroad's debt obligations, at the time of the Amended Complaint, consisted of almost \$6.9 million principal amount of First Mortgage Bonds, \$2.7 million of Income Promissory Notes and \$14.5 million of equipment obligations. (A.7)

All the events upon which the thirteen counts in the Amended Complaint are based occurred between 1960 and 1967. (A.8-20)

³ Amoskeag formerly was an investment company registered under Section 8 of the Investment Company Act of 1940, 15 U.S.C. § 80a-8, but this registration ceased by S.E.C. order effective November 3, 1972.

SUMMARY OF ARGUMENT

I

The Railroad is a Maine public utility corporation organized "for the purpose of . . . operating a railroad for public use". The Amended Complaint alleges that the causes of action asserted belong to the Railroad and are asserted directly by it. There is no evidence in the record indicating otherwise. The separate identity of the Railroad should not be disregarded solely because the Railroad has a majority stockholder.

The public interest involved requires that the Railroad be recognized as a separate entity. Numerous Supreme Court cases recognize the public interest in the proper management of railroads. It has been frequently asserted that railroads are "public highways". The Transportation Acts of 1920 and 1940 and the Regional Rail Reorganization Act of 1973 recognize the public interest in railroads. Mergers involving railroads are regulated in the public interest under Section 5(2) of the Interstate Commerce Act. Railroad reorganizations are effectuated under a special part of the Bankruptcy Act, Section 77, which assures that the public interest will be considered. In Maine, also, there are numerous cases recognizing the distinctive status of railroads, and railroads in Maine have the power of eminent domain. The line of cases, upon which BP and BPO rely to bar this suit by the Railroad, involve ordinary private business corporations.

Also, the *Home Fire* case itself, while dismissing counts brought in equity, allowed the plaintiff to recover on counts at law. All of the counts brought by the Railroad are at law, not in equity. Therefore, the court of appeals correctly

distinguished *Home Fire* in holding that the Railroad could maintain this action.

II

The Railroad has standing to bring this action, because it has suffered direct injuries as a result of BP and BPO's illegal actions. The common law counts are based on simple conversion. It is alleged that BP and BPO took assets of the Railroad illegally and without giving adequate consideration. The Railroad has standing under Section 4 of the Clayton Act, because it has alleged that it was injured in its business or property by acts of BP and BPO that violated Section 10 of the Clayton Act. The Railroad has standing under SEC Rule 10b-5, because it is alleged that the Railroad was involved in the purchase and sale of securities with BP and BPO, because BP and BPO used fraudulent and deceptive practices in connection with the securities transactions, and because the Railroad was injured as a result.

III

Rule 23.1, F.R.Civ.P., does not apply to this case, because the action is brought by the Railroad and not by a stockholder on behalf of the Railroad. In a derivative case the plaintiff-stockholder is required to allege that he made demand on the corporation to bring the action and that the Board refused. But here the Board voted to have the Railroad bring the suit. The purposes behind Rule 23.1 do not apply here. There has been no transfer in anticipation of suit to create federal jurisdiction. This is not a strike suit by a minority stockholder.

In addition BP and BPO are trying to use Rule 23.1 as a basis for an affirmative defense. This is an impermissible use of the rule, because it would abridge or modify the

substantive rights of the Railroad. Rule 23.1 may be used only to determine whether a particular plaintiff-stockholder has standing to assert a cause of action belonging to his corporation.

IV

Any recovery here will not be available to Amoskeag as a windfall, because the district court has the power to frame a decree limiting the use of the funds recovered to such purposes as upgrading of track and roadbed or purchase of equipment. Thus, the public would receive the direct and immediate benefit of improved transportation services.

ARGUMENT

I. THE COURT OF APPEALS CORRECTLY HELD THAT A RAILROAD MAY SUE IN ITS OWN NAME AND BEHALF TO RECOVER ASSETS WHICH ITS FORMER MAJORITY STOCKHOLDER DIVESTED FROM IT IN VIOLATION OF FEDERAL AND STATE LAW

This action at law was commenced by the Railroad, a Maine public utility, to recover damages for assets of which it was divested by action of its former controlling stockholder. It was brought in response to the ICC Report which had concluded that, although the depredations committed by the former majority stockholder were completely reprehensible and ought to be punished, under existing law and regulations there was nothing the Commission could do about it.⁴ The Railroad itself thus undertook to right the wrong.

⁴See pp. 53-55 *infra*. These parts of the ICC Report make specific recommendations regarding future Commission action to control these practices.

The district court dismissed the entire complaint, treating it as a typical shareholder's derivative suit barred by the contemporaneous ownership rule, Rule 23.1, F.R.Civ.P., and by equitable principles. To reach that conclusion, the court had to find, contrary to the pleadings, that the action was brought by the present majority stockholder and not by the Railroad.

The court of appeals reversed. It held that the Railroad should be permitted to maintain its action; indeed it had a duty to do so. (A.61) Protection of the public interest in the Railroad's ability to survive and provide services far outweighed any windfall which the present majority stockholder, not a wrongdoer, might receive.

We submit that the decision of the court of appeals is correct and should be affirmed. The Railroad has been injured; its right of recovery ought not to be cut off because the wrongdoer managed to sell its stock before the wrong was uncovered.

A. This Action Is Brought By The Railroad And Not By Its Present Majority Stockholder

The Amended Complaint is brought by the Railroad (and its wholly-owned subsidiary), a Maine corporation organized "for the purpose of constructing, maintaining and operating a railroad *for public use*". (A.1-2) (emphasis added) It was filed with the unanimous vote of the Railroad's Board of Directors after the Board, with special counsel, had reviewed the Complaint "paragraph by paragraph". (A.45-7) It should be noted that at the time the Railroad's Board of Directors authorized the litigation, twelve of its seventeen members had been directors during the old regime, that is, before the present majority stock-

holder, Amoskeag, purchased its shares in October 1969. (A.44) Of the ten directors voting to authorize the suit, a majority, six, had been serving prior to 1969.

In other words, the record is quite clear that Amoskeag did not change the Railroad's Board after it purchased its stock and then cause the new Board to bring the action. The Board which authorized commencement of the litigation was controlled by directors who had served while BP and BPO owned and controlled the Railroad, and who continued to serve after it was sold to Amoskeag.

BP and BPO refuse to accept the fact that this is the Railroad's action. An analysis of their Brief discloses that the success of their argument depends entirely upon convincing this Court, contrary to fact⁵, that this is Amoskeag's suit. Thus, BP and BPO argue:

It is clear, however, that even if the public right assumed by the First Circuit did exist, Amoskeag would not have standing to assert it. . . The starting point of any consideration of standing in the instant case is the undisputed fact that the real plaintiff and party in interest suffered no injury as a result of the acts upon which the suit is brought." (Petitioners' Brief, Pg. 7)

For purposes of this case, at least, BP and BPO deny the separate identities of the Railroad and its majority stockholder. This is clearly contrary to the law of Maine and the decisions of this Court.

In *Ulmer v. Lime Rock Railroad Company*, 98 Me. 579,

⁵BP and BPO filed with their motion for summary judgment no affidavits or other evidentiary material to contradict the allegations that "The causes of action asserted in this Amended Complaint belong to [the Railroad] and are asserted directly by it" (A.5). The Houston affidavit, filed by the Railroad (A.43-7), supports these allegations.

57A.1001 (1904), the Supreme Judicial Court, in rejecting the argument that, since all of the stock of the railroad (except for director qualifying shares) was owned by a private corporation, the railroad was being used for a private rather than public purpose and hence should not exercise the power of eminent domain, observed at 594, and at 1006:

“Whoever may be the owner of the stock of the railroad company, or however many or few such owners there may be, that corporation still continues to exist as a separate and independent corporation; it preserves its corporate existence, it operates its own road, it has its own officers and makes its own contracts. . . Neither do the stockholders of a corporation control the property of the corporation . . . [T]he control of the property of the corporation is in the corporation itself and in its officers and agents. . .”

See also *Wells v. Dane*, 101 Me. 67, 63A.324 (1905) where the court insisted the corporation rather than its majority stockholder bring the action at law against the wrongdoer since the wrong was primarily against the corporation.

In *Pullman's Palace Car Co. v. Missouri Pacific*, 115 U.S. 587 (1885) this Court found that, although the Missouri Pacific owned enough of the stock of the St. Louis, Iron Mountain and Southern to control election of its directors, “the directors now control the road through their own agents and executive officers, and these agents and officers are in no way under the direction of the Missouri Pacific Company.” *Id* at 597. Accordingly, this Court refused, in equity, to enforce a contract against the St. Louis, Iron Mountain and Southern on the theory that Pullman had the same contract with Missouri Pacific. [See also, *Home Telephone Company v. Darley*, 355 F.Supp. 992, 998 (N.D. Miss. 1973), where the court held that the separate identity of a corporation cannot be disregarded just because all of its

common stock is owned by another corporation.]

We submit that no tenable argument can be made on the basis of the record before this Court, either at law or in equity, that the present action is Amoskeag's and not the Railroad's.

B. The Public Interest In The Affairs Of Railroads, Well-Recognized In Both Federal And State Law, Makes This Action Mandatory

The court of appeals determined that the Railroad "should be permitted, and indeed *has a duty*, to recover for itself any assets which were divested from it in violation of state or federal law". (A.61) (emphasis added) The opinion makes clear that the duty is derived from the high degree of the public interest "unlike the private interest of stockholder or creditor" in the ability of a railroad to provide services "and, indeed to survive". (A.60)

The public interest in railroads has elicited a wealth of strong judicial and legislative statements in support thereof.

Supreme Court Cases

In *Barton v. Barbour*, 104 U.S. 126 (1881), a tort action against a railroad receiver, this Court stated at 135:

"A railroad is authorized to be constructed more for the public good to be subserved, than for private gain. As a highway for public transportation, it is a matter of public concern, and its construction and management belong primarily to the Commonwealth, and are only put into private hands to subserve the public convenience and economy. But the public retain rights of vast consequences in the road and its appendages. . ."

Public interest in the management and operation of a railroad was also declared by this Court in *Union Trust Co. of New York v. Illinois Midland Ry. Co.*, 117 U.S. 434, 455-6 (1886).

As to the relative priority of a railroad's stockholders vis-à-vis the public, this Court declared in *Woodstock Iron Company v. Richmond and D. Extension Co.*, 129 U.S. 643, 656-7 (1889):

"All arrangements . . . by which directors or stockholders or other persons may acquire gain, by inducing those [railroad] corporations to disregard their duties to the public, are illegal and lead to unfair dealing, and thus going against public policy will not be enforced by the Courts".

See also *Commissioners of Buncombe County v. Tommey*, 115 U.S. 122, 128-9 (1885), *U.S. v. Trans-Missouri Freight Association*, 166 U.S. 290, 321-2, 332-3 (1897), *Eckington & S.H.R. v. McDevitt*, 191 U.S. 103, 114 (1903), and *Charlotte C. & A.R. v. Gibbes*, 142 U.S. 386, 393 (1892)

Most of the more recent decisions of this Court involving the public interest and railroads have focused on mergers under Section 5(2) of the Interstate Commerce Act.⁶ The Transportation Act of 1940 amended this section in such a way as to give explicit statutory recognition to the public interest. Thus, the Commission under Section 5(2) must consider the effect of the proposed transaction "upon adequate transportation service to the public" and "the effect upon the public interest of the inclusion, or failure to include, other railroads in the territory involved in the proposed transaction". The concern of this Court in the more recent merger cases with the financial health of the

⁶ 49 U.S.C. § 5(2) The text appears in Appendix A to this brief.

affected railroads is well documented in its decisions.⁷ In the recent *New Haven Inclusion Cases*, 399 U.S. 392 (1970), this Court found that the public interest in railcarriers is paramount to the financial interest of the carrier's bondholders. *Id* at 491-2.

Maine Cases

The court of appeals pointed out that Maine railroads are regulated public utilities under 35 M.R.S.A. §15. The concept of railroads as public highways is also recognized in Maine law.

"That the ordinary purposes for which railroads are constructed and operated, the transportation of freight or passengers, are essentially public in their nature and of great public convenience and utility is, of course, conceded. 'They are public highways; great thoroughfares of public travel and convenience'. *In re Railroad Commissioners*, 83 Maine, 273." *Ulmer v. Lime Rock Railroad Company*, 98 Me. 579, 585, 57A.1001, 1003 (1904)

See also *Spofford v. B & B Railroad*, 66 Me. 26 (1876)

Maine railroad charters are contracts made by the legislature in behalf of the public.⁸ They are "preeminent" among private instrumentalities affected with a public interest.⁹ In reaching its conclusion in the instant case the court of appeals also cited the relatively recent case of

⁷ E.g. *Baltimore & Ohio R. Co. v. U.S.*, 386 U.S. 372, 384-6 (1967). See also *Norfolk & W. Ry. Co. and New York C. & St. L.R. Co. Merger*, 324 ICC 1, 85-89 (1964), *Penn-Central and N. & W. Inclusion Cases*, 389 U.S. 486, 500-1 (1968).

⁸ *Railroad Com'rs v. Portland and O.C.R.R.*, 63 Me. 269, 278 (1872), which was cited by the court of appeals (A.61).

⁹ *Id* at 275.

Maine Central Railroad v. P.U.C., 156 Me. 284, 163A.2d 269 (1960) for the proposition that every citizen in Maine has a stake in the health of its railroads. (A.64-5)

The special distinction of railroads insofar as the public interest is concerned, as contrasted with other private corporations, is fundamental to Maine law.

"In the circumstances of their origin, and in their powers, uses and duties railroad corporations are clearly distinguishable from other merely private corporations; and, unless we keep these characteristics in view when we come to determine the rights, powers and duties of such corporations, and the authority, express, implied or reserved, of the legislature and court in respect to them, we shall run the hazard of confounding dissimilar distinctions and committing grave errors," *R.R. Commissioners v. Portland and O.C.R.*, 63 Me. 269, 277 (1872)

Legislation and Administrative Action

The court of appeals correctly observed that the public's special interest in railroads has been reflected in the separate Transportation Acts of 1920 and 1940; enactment of Section 77 of the Bankruptcy Act (1933); and the Commission's current *Northeastern Railroad Order of Investigation* (Ex Parte No. 293). Since the court of appeals decision, Congress has passed and the President has signed, in response to the present rail crisis in the Northeast and Midwest, the Regional Rail Reorganization Act of 1973 (P.L. 93-236), the first time in its history that the federal government has made a long-term commitment to become involved in railroad operations and management with

taxpayer funds.¹⁰

The extraordinary "cram down" provisions of a railroad reorganization court under Section 77(e), as contrasted with corresponding provisions (i) under Chapter X reorganizations where the plan must be accepted by creditors holding two-thirds in amount of each class of claims and, if the debtor is not insolvent, by stockholders holding the majority of stock of each class, 11 U.S.C. § 579, and (ii) under Chapter XI arrangements where the arrangement must be accepted by a majority of the creditors in each class holding a majority in amount of the claims in such class (11 U.S.C. § 762), attests to the high priority given to the public interest in railroads, even at the expense of creditors holding first liens and mortgages on rail assets.

Of course, the Interstate Commerce Act itself, 49 U.S.C. §§ 1 *et seq.*, must be considered a manifestation of public interest and concern. To cite but one example from that Act, consider the lengths to which the "public convenience and necessity" is protected when a railroad seeks to discontinue or change service. The Railroad must give advance notice, and the Commission may investigate, hold hearings, and require the railroad to continue the service. 49 U.S.C. § 13a.

¹⁰ See, *Texas & P. R. Co. v. Gulf, C. & S. F. Co.*, 270 U.S. 266, 277 (1926): "Congress . . . recognized that the preservation of earning capacity, and conservation of financial resources, of individual carriers is a matter of national concern . . ." in enacting the Transportation Act of 1920. Maine's direct investment in the Railroad is evidenced by Chapter 250 Private and Special Laws of Maine, 1891 (Pg. 374) and Chapter 193 Private and Special Laws of Maine, 1895 (Pg. 254), both empowering the County of Aroostook "to aid in the construction of a railroad through said County, and to acquire and hold preferred stock of the Company building such railroad."

In *Dayton-Goose Creek R. Co. v. U.S.*, 263 U.S. 456 (1924) this Court, in passing upon the rate provisions of the Transportation Act of 1920, stated at 481:

“The carrier owning and operating a railroad, however strong financially, however economical in its facilities, or favorably situated as to traffic, is not entitled, as of constitutional right, to more than a fair net operating income upon the value of its properties *which are being devoted to transportation*. By investment in a business dedicated to the public service the owner must recognize that, as compared with investment in private business, he cannot expect either high or speculative dividends, but that his obligation limits him to only fair or reasonable profit”. (Emphasis added)

What BP and BPO did, we submit, was to take assets of the Railroad, which were being devoted to transportation, and move them upstairs into a private non-regulated business where they would be available to earn more than a regulated reasonable profit without thereafter being reinvested in the Railroad. Clearly, this violated the intent of Congress and the policy which it had established and reaffirmed under the two separate Transportation Acts, and, we suggest, may have been the kind of practice which ultimately produced the rail crisis to which the Regional Rail Transportation Act of 1973 is addressed.

In *Katy Industries, Inc. — Control — M-K-T R.Co.*, 331 I.C.C. 405 (1967), the very same BP and BPO sought control of the M-K-T Railroad under a plan to place ownership of the railroad in a non-carrier holding company which would make investments in high yielding non-transportation companies. The argument was made before the Commission by BP and BPO that the greater return on investments would

be directed back into the railroad — in short, that unregulated profits would be invested in a regulated industry.¹¹ It is impossible to reconcile BP and BPO's announced purpose to the Commission in the *Katy* case with its action in this case. In fact, the Commission subsequently specifically rejected the argument made by BP and BPO in *Katy*:

"Bangor Punta group has often been cited by those in favor of railroad diversified holding companies as an example of the railroad receiving benefits from a holding company relationship. The claims were based on the premise that Bangor and Aroostook Railroad service is better because of the capital available for its activities from Bangor Punta, which would not ordinarily be available to the Railroad. This allegedly resulted in an overall improved financial condition of the Railroad.

Our review disclosed the contrary. The Railroad has been contributing funds to the holding company by payment of special dividends; lending funds at rates below prevailing interest rates; using Railroad's credit; and by borrowing funds at local banks to pass on to the holding company.

Regardless of all the glowing self-serving statements made in current merger proceedings, our belief is that when circumstances warrant, these managements will involve the railroads in similar transactions". (ICC Report, at pp. 47-8, *infra*)¹²

¹¹ The Commission dismissed the case for lack of jurisdiction.

¹² The ICC Report also states that "there is no evidence to indicate any concern or consideration was at any time given to the responsibility of the carrier to the public". (at p: 50, *infra*)

C. The Railroad Should Not Be Prevented From Bringing This Action Simply Because Its Present Majority Stockholder Did Not Own Its Stock During The Period Of Wrongful Conduct

The corporations which were subjects of concern in the various cases upon which BP and BPO so completely rely¹³, were not public utilities. Recoveries would not accrue substantially to the public's benefit. These corporations were not the subject of repeated Congressional legislation, federal regulation and inquiry. They did not have powers of eminent domain.

The court of appeals rejected *Home Fire's* treatment of the corporation as the alter ego of its stockholders where recovery would benefit persons other than the stockholders. Railroads "cannot realistically be described as mere alter egos of their chief stockholders". (A.59)

We respectfully submit that there are additional reasons why this Court should not follow the *ratio decidendi* of *Home Fire*. In the first place, contrary to the assertion of Petitioners' Brief (Pg. 17), there is considerable authority allowing suits which *Home Fire* would seemingly not allow.¹⁴ Secondly, the Maine cases are disposed to permit such suits. *Hyams v. Old Dominion Company*, 113 Me. 294,

¹³ *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N.W. 1024 (1903) and like cases *Capital Wine & Spirit Corp. v. Pokrass*, 277 App. Div. 184, 98 N.Y.S.2d 291 aff'd, 302 N.Y. 734, 98 N.E.2d 704 (1951); *Amen v. Black*, 234 F.2d 12 (CA10 1956) and *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 A. 645 (1917).

¹⁴ Two cases which cite *Home Fire* and refuse to follow it are *Bank v. Coal Corp.*, 133 W.Va. 639, 653-5, 57 S.E.2d 736, 746 (1950) and *Peterson v. Hopson*, 306 Mass. 597, 611-2, 29 N.E.2d 140, 149 (1940). Earlier cases are collected in Sykes, *Right of a Stockholder to Attack Transactions Occurring Prior to His Acquisition of Stock*, 4 Md.L.Rev. 380, 380 n.2 (1940).

93A.747 (1915), specifically approved in *Forbes v. Wells Beach Casino, Inc.*, 307 A.2d 210, 223 (Me. 1973) Thirdly, *Home Fire* itself disregarded the separate corporate entity only in connection with the claims in equity. Judge Pound allowed the corporation to assert claims at law:

"Hence, we think the rule to apply to such cases is this: where a corporation is proceeding *at law* . . . the corporation is regarded as a person separate and distinct from its stockholders, or any or all of them." *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 679-680, 93 N.W. 1024, 1032 (1903) (emphasis added)¹⁵

Thus, Barber was held to be liable to the corporation for money converted under guise of paying for services.

BP and BPO's reliance on *Home Fire* depends upon disregarding the separable interests of the Railroad and Amoskeag, possibly because BP and BPO did exactly that while they controlled the Railroad. But in actions at law, as Dean Pound stated, the interests are separable and distinct. We submit that this is also the better rule for suits in equity where legal causes of action are alleged. See *Groome et al v. Steward*, 142 F.2d 756, 756 (CA DC 1944)

When the scheme of BP and BPO was hatched in 1960, the Railroad was the parent corporation owning two subsidiaries, both engaged in businesses directly related to it. By 1964, the Railroad had become one of five subsidiaries, none of the other four being in a business related to railroading. By 1968, the Railroad was one of some fifty active subsidiaries or divisions of BP and BPO with the businesses of the others completely or largely unrelated to railroad-

¹⁵ See, also, *Amtorg Trading Corp. v. U.S.*, 71 F.2d 524 (C.C.P.A. 1934)

ing.¹⁶ The ICC Report reveals that the Railroad's contribution to consolidated revenues of its parent corporation dropped from 19% in 1964 to only 6% in 1968; that during the same period the Railroad's contribution to consolidated profits of its parent declined from 22% to 1%.¹⁷

"In such a situation, a holding company might be inclined to dispose of a railroad after having used it advantageously."¹⁸ And that is exactly what happened. On October 2, 1969, BP and BPO sold all of their Railroad stock (98% of the Railroad) to Amoskeag, "whose president, F. C. Dumaine, Jr. and family have long been associated with the railroad industry [and who] . . . formerly was president of the New York, New Haven and Hartford, and the Delaware and Hudson Railroads".¹⁹ It was the first time that a public carrier had been sold by a conglomerate.²⁰

By permitting this suit to be maintained, this Court will not open the floodgates to litigation, as BP and BPO argue. The party directly injured is bringing the suit against the wrongdoer. That party, the Railroad, is a public asset. The public has a legitimate interest in the conduct of the Railroad's affairs, evidenced by the legislation and regulation to which it is subject. The case is clearly distinguishable from *Home Fire* and those which follow it. The deterrent

¹⁶ ICC Report, pp. 81-8, *infra*

¹⁷ *Ibid*, p. 47, *infra*

¹⁸ *Ibid*. p. 47, *infra*

¹⁹ *Ibid*. p. 91, *infra*. In ICC Finance Docket No. 26115, Boston and Maine Corporation Reorganization, Amoskeag has filed a plan of reorganization of the Boston and Maine Railroad and has announced its intention of combining that railroad with the Maine Central and the Bangor & Aroostook Railroad into a northern New England system. See *In Re Boston and Maine Corporation*, 484 F.2d 369, 371 (CA1 1973).

²⁰ ICC Report, p. 48, *infra*

effect of this litigation should not be overlooked. By permitting this suit to be maintained, this Court will be giving effect to the declared federal and state policy of protection of the public interest in railroads and declaring that such public interest is better served by not granting civil immunity "to those who may have syphoned funds from a rail carrier in violation of state and federal law". (A.66-7)

II THE RAILROAD AND ITS SUBSIDIARY HAVE STANDING TO BRING THIS ACTION BECAUSE THEY HAVE BEEN DIRECTLY INJURED BY BP AND BPO'S ILLEGAL ACTIONS

Conversion

In Count I the Railroad has alleged that its funds were converted by the BP and BPO.²¹ (A.8-9) This alone is a more direct and immediate injury than was suffered by the plaintiffs who were held to have standing in *Flast v. Cohen*, 392 U.S. 83 (1968), or *Assoc. of Data Processing Service Organizations, Inc. v. Camp*, 397 U.S. 150 (1970).

Clayton Act Violation

Standing to sue for violations of the Clayton Act is conferred by Section 4 of the Act, 15 U.S.C. §15, which provides:

"[A]ny person who shall be injured in his business or property by reason of anything forbidden in the anti-trust laws may sue therefor. . ."

Count IV alleges the Railroad has been injured by violation of Section 10 of the Clayton Act, 15 U.S.C. §20, which was enacted:

²¹ Diversity jurisdiction is alleged as a jurisdictional basis for this count. (A.1-3) Also there may be pendent jurisdiction.

"to prohibit a corporation from abusing a carrier by palming off upon it securities . . . without competitive bidding and at excessive prices through overreaching by . . . common directors, to the financial injury of the carrier and the consequent impairment of its ability to serve the public interest." *Minneapolis & S.L. Ry. v. United States*, 361 U.S. 173, 190 (1959); quoted in *Klinger v. Baltimore and Ohio Railroad Company*, 432 F.2d 506, 512 (CA2 1970).

Here over ten thousand shares of a security were "palmed off" on the Railroad at an excessive price. (A.11-13) The cause of action is not "completely devoid of merit", *Oneida Indian Nation v. Oneida*, 42 U.S. Law Week 4195, 4197 (U.S. Sup. Ct., January 21, 1974); the assertion of the cause of action is enough to satisfy jurisdictional requirements. *Romero v. International Terminal Operating Co.*, 358 U.S. 354, 359 (1959).

Since the Railroad is the "person injured" within Section 4 and a "carrier" within Section 10, it may assert the cause of action.²² *Klinger v. Baltimore and Ohio Railroad Company*, 432 F.2d 506, 512 (CA2 1970); and see *Cleary v. Chalk*, 488 F.2d 1315, 1319 n.17, 1321-4 (CA2 1973) BP and BPO have asserted no rationale, based on the aims and purposes of the antitrust laws why the Railroad should be denied standing. *Perma Life Mufflers v. International Parts*, 392 U.S. 134, 143 (1968)

Securities Exchange Act Violation

Similarly, the Railroad and its subsidiary have standing to assert the violations of Rule 10b-5 alleged in Counts VI,

²² Amoskeag, as a stockholder of an injured corporation, is not a "person injured" within Section 4. *Kauffman v. Dreyfus Fund, Inc.*, 434 F.2d 727, 732 (CA3 1970), cert. denied 401 U.S. 974.

VIII, X and XIII of the Amended Complaint. (A.14-20) As this Court has held, "[Rule 10b-5] protects corporations as well as individuals who are sellers of a security." *Superintendent of Insurance v. Bankers Life and Casualty Co.*, 404 U.S. 6, 10 (1971). A majority stockholder, such as BP and BPO, may be held liable to the corporations it controls for violations of Rule 10b-5. *Schoenbaum v. Firstbrook*, 405 F.2d 215, 219 (CA2 1968) (in banc), cert. denied 395 U.S. 906. Existence of a remedy under state law does not negate the federal remedy. *Vine v. Beneficial Finance Company*, 374 F.2d 627, 635-6 (CA2 1967), cert. denied 389 U.S. 970. This Court has said:

"Since there was a 'sale' of a security and since fraud was used 'in connection with' it, there is redress under Section 10(b), whatever might be available as a remedy under state law." *Superintendent of Ins. v. Bankers Life and Cas. Co.*, 404 U.S. 6, 12 (1971)

The Railroad and its subsidiary have alleged (A.10-15) a sale of securities and fraud and damages relating thereto, and therefore they have stated causes of action under Section 10(b).²³

In actions under Rule 10b-5 courts have approved "wind-fall" recoveries rather than let a wrongdoer profit from illegal acts. In *Janigan v. Taylor*, 344 F.2d 781 (CA1 1965), cert. denied 382 U.S. 879, the court held at 786, "It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them." This rule of damages, along with the *Janigan* case, was cited with

²³ Since Amoskeag was not a seller of the St. Croix stock, it would not have standing itself under Section 10(b) to challenge the St. Croix transaction. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 464 (CA2 1952), cert. denied 343 U.S. 956.

approval in *Affiliated Ute Citizens v. U.S.*, 406 U.S. 128, 155 (1972).²⁴

In view of the law cited herein and of the injuries and damages suffered, the Railroad and its subsidiary have alleged causes of action within the traditional boundaries of Maine common law, of Section 10 of the Clayton Act, and of SEC Rule 10b-5. There is no language in the decision below that creates any new "unsanctioned" causes of action, as BP and BPO argue in their brief, pp. 11-16. The court of appeals did not discuss the boundaries of causes of action under the Clayton Act or under Rule 10b-5, because BP and BPO did not raise these issues below. While BP and BPO did argue below the scope of the cause of action, if any, under the Maine Public Utilities Act, the court of appeals declined to pass on this issue. (A.67) Thus, the decision below did not create any cause of action, let alone an "unsanctioned" one, under this statute.

Since it was the Railroad and its subsidiary that had their assets converted, that were injured in their business and property, and that sold the St. Croix stock, the Railroad and its subsidiary should be allowed to maintain this action.

²⁴ See also the cases that allow a tippee to recover damages from his tipper, e.g. *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F.Supp. 50, 57-8 (S.D.N.Y. 1971) and that allow an investor to recover damages from his broker for violation of the margin requirements, e.g. *Pearlstein v. Scudder & German*, 429 F.2d 1136, 1141 (CA2 1970), cert. denied 401 U.S. 1013. Clearly, in furtherance of the policy of deterring unlawful acts, the courts have permitted recovery under the securities laws when plaintiff itself may be a wrongdoer. In this case, neither the Railroad nor Amoskeag is a wrongdoer, as recognized in the court of appeals opinion. (A.65)

III. RULE 23.1 SHOULD NOT BE APPLIED TO PREVENT THE RAILROAD FROM MAINTAINING THIS ACTION

A. The Language and Purposes of Rule 23.1 Are Inapplicable.

Rule 23.1 applies to derivative actions where the directors of a corporation have refused to act for and in its behalf. Thus, the plaintiff is required to allege "with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors". The purpose of Rule 23.1 is to regulate when a suit may be controlled by a stockholder rather than the board of directors of the corporation. *In re Kauffman Mutual Fund Actions*, 479 F.2d 257, 263 (CA1 1973), cert. denied ~~No.~~—U.S.—, 38 L.Ed.2d 107. But here the Railroad's Board authorized this suit to be brought by the Railroad itself, under the control of the Chief Executive Officer of the corporation subject to review by the directors. (A.43-7) Rule 23.1 does not apply to this situation. *Mauck v. Mading-Dugan Drug Company*, 361 F.Supp. 1314, 1318 (N.D. Ill. 1973), *Central Ry. Signal Co. v. Longden*, 194 F.2d 310, 321 (CA7 1952) (alternate holding).

Further the purposes behind Rule 23.1 do not apply here. As the court of appeals wrote in its decision:

"The underlying policies for adoption of the Rule — preventing transfer of a few shares to a non-resident to acquire diversity jurisdiction and to discourage strike suits — relate to abuses associated with minority stockholder proceedings. See *Hawes v. Oakland*, 104 U.S. 450 (1882); 3B Moore's Federal Practice, Paragraph 23.1.15" (A.60)

Since the reasons behind Rule 23.1 do not apply, the rule itself should not be applied. *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363, 371 (1966), *Hirshfield v. Briskin*, 447

F.2d 694, 698 (CA7 1971), *Bateson v. Magna Oil Corporation*, 414 F.2d 128, 131 (CA5 1969), cert. denied 397 U.S. 911, *Hoff v. Sprayregan*, 52 F.R.D. 243, 247 (S.D.N.Y. 1971)

B. Rule 23.1 Is Procedural And May Not Be Used To Deny The Railroad Its Substantive Rights

The federal rules may not be given substantive effect, because they were adopted pursuant to Congressional authorization requiring that they "shall not abridge . . . or modify any substantive right." 28 U.S.C. § 2072. See *Sibbach v. Wilson*, 312 U.S. 1, 13 (1940), reh. denied 312 U.S. 655.

BP and BPO by their motion for summary judgment are attempting to use Rule 23.1 in a substantive manner to provide an affirmative defense on the merits. (A. 29, 41) The court of appeals, perceiving that BP and BPO were asserting the contemporaneous ownership rule as a defense against the *Railroad's* maintaining the suit, correctly analyzed the issue before it as "whether the corporation, suing in its own right, should be estopped by equitable defenses pertaining only to its controlling stockholder". (A.60) But:

"Simply because a particular [plaintiff-stockholder] cannot qualify as a proper party to maintain [a derivative] action does not destroy or even whittle at the cause of action. The cause of action exists until a qualified plaintiff can get it started in a federal court." *Perrott v. United States Banking Corp.*, 53 F.Supp. 953, 956 (D.Del. 1944); cited with approval in the Advisory Committee Note of 1946 to Rule 23.1, 3B Moore's *Federal Practice*, p. 23.1-15. See also *Ross v. Bernhard*, 396 U.S. 531, 538 (1970).

If this Court were to determine, as did the district court, that this was Amoskeag's suit, the proper result would be to hold that Amoskeag does not have standing to bring a suit

on behalf of the Railroad. But any of the Railroad's other stockholders could cause the Railroad to bring the action by making demand upon the Railroad, or could even intervene to carry on this suit. *Truncale v. Universal Pictures Co.*, 11 F.R. Serv. 24c.3, Case 1 (S.D.N.Y. 1948). In such a case, the Railroad's recovery would be its full damages; there is no pro-rata reduction of recovery as BP and BPO contend. *Norte & Company v. Huffines*, 416 F.2d 1189, 1190 (CA2 1969), cert. den. 397 U.S. 989. *Central Ry. Signal v. Longden*, 194 F.2d 310, 321-2 (CA7 1952); *Overfield v. Pennroad Corp.*, 48 F.Supp. 1008, 1018 (E.D.Pa. 1943), modified 146 F.2d 889 (CA3 1943). The present stockholders who were not stockholders at the time of the wrongs sued upon, such as Amoskeag, "are not unjustly enriched by the award to the corporation because at the time of purchase they acquired a proportionate indivisible interest in the claims asserted" in the action in the corporation's behalf. *Norte & Company v. Huffines*, 288 F.Supp. 855, 865 (S.D.N.Y. 1968), affirmed 416 F.2d 1189, cert. den. 397 U.S. 989.

Thus, Rule 23.1 may not be used as a basis for dismissing on the merits the claims brought by the Railroad and its subsidiary.

IV. THE DISTRICT COURT MAY FRAME A DECREE TO INSURE THAT ANY RECOVERY WILL NOT BENEFIT THE PRESENT MAJORITY STOCKHOLDER AT THE EXPENSE OF THE RAILROAD AND THE PUBLIC.

The "windfall" if any, which is said will be available to Amoskeag if recovery is obtained, may be circumscribed in such a way as to insure that it will be used for the benefit of the railroad. The court of appeals had no doubt that the district court has power to frame a decree which would prohibit distributions by the Railroad which would conflict with state or federal law. We submit that the broad powers of

the district court, which can act as a court of equity for purposes of framing a decree in an action at law, are sufficient to insure that any recovery would be reinvested in the Railroad for, as examples, upgrading of way or purchasing of equipment. But if such power is not sufficient, the Railroad stated to the district court that the Railroad would voluntarily enter into a Stipulation to such effect, in which Amoskeag would voluntarily join if requested.

In *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964) where this Court recognized a private right of action for violation of Section 14(a) of the Securities Exchange Act of 1934, it was held that the courts were "to be alert to provide such remedies as are necessary to make effective the Congressional purpose" of the legislation involved. *Id.* at 433-4. In *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970) it was observed that in selecting a remedy the lower courts should exercise the sound discretion which guides the determinations of courts of equity. *Id.* at 386. And see *Hecht Co. v. Bowles*, 321 U.S. 321, 329-330 (1944), and *Meredith v. Winter Haven*, 320 U.S. 228, 235 (1943). In *Bell v. Hood*, 327 U.S. 678 (1946) this Court declared at 684:

"... where federally protected rights have been invaded, it has been the rule from the beginning that courts will be alert to adjust their remedies so as to grant the necessary relief. And it is also well settled that where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done."

Improved equipment and rights of way of the Railroad may indirectly benefit Amoskeag by increasing the value of its equity. But such expenditures do not necessarily increase the price Amoskeag would receive if it were to sell its stock.

The value of the stock of solvent railroads for consolidation or sale purposes is determined by a number of factors, including earning capacity, historical income (with non-recurring items eliminated), balance sheet strength, savings that might be effected as a result of the consolidation or purchase, dividend history and condition of plant and equipment. Under a suitably framed decree only the last of these factors would be directly enhanced by the Railroad's recovery.

In *Home Telephone v. Darley*, 355 F.Supp. 992 (N.D. Miss. 1973), the court declared at 998:

"We are not impressed with the argument that a recovery by Home for its substantial loss, thus being restored to its former net worth position, is a 'reward' to Union. A recovery in this case will inure directly to Home's benefit, and only incidentally to Union as sole common shareholder."

There is no question, however, that the public would be the immediate beneficiary of improved equipment and way.

The district courts have shown considerable ingenuity and imagination in fashioning decrees, particularly in the antitrust area. *United States v. Ford Motor Company*, 286 F.Supp. 407 (E.D.Mich. 1967), 315 F.Supp. 372 (E.D.Mich. 1970), affirmed 405 U.S. 562 (1972). Their combined law and equity power may be employed to insure that full justice is done.²⁵

²⁵ Divestiture and a mandatory injunction are available to a private plaintiff bringing an action under Section 16 of the Clayton Act. *International T. & T. Corp. v. General Telephone & Electric Corp.*, 351 F.Supp. 1153 (D.Haw. 1972). See also, *Groome et al v. Steward*, 142 F.2d 756 (C.A.D.C. 1944) where the distinction between law and equity is erased (except in jury trials) and the parties must be given relief to which they are entitled on the facts, "applying the rules of both law and equity as a single body of principles and precedents". *Id* at 756.

We submit that, if syphoning off of the Railroad's recovery is a major concern for this Court, an appropriate decree or stipulation may be framed to remove such concern.

CONCLUSION

For all these reasons, the judgment below should be affirmed.

In the court of appeals the Railroad and its subsidiary argued that the *Home Fire* rationale²⁶ should not be applied to bar claims under the Federal antitrust and securities laws.²⁷ The court of appeals reserved judgment on these points. (A.59) If the judgment is to be reversed on the basis of the *Home Fire* rationale, and if this Court does not pass on the arguments reserved in the court of appeals, then this Court should remand this case to the court of appeals to have these arguments passed upon.

Respectfully submitted.

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²⁶ See Petitioners' Brief, p. 17-18.

²⁷ The arguments made by the Railroad in the court of appeals are summarized in Appendix C, pp. 103-4 below.

APPENDIX A**STATUTES AND REGULATIONS INVOLVED****Clayton Act § 4 (15 U.S.C. § 15):**

[Suits by persons injured]

Sec. 4. That any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

Interstate Commerce Act § 5(2) (49 U.S.C. § 5(2):

§ 5, par. (2). **Unifications, mergers, and acquisitions of control.** (a) It shall be lawful, with the approval and authorization of the Commission, as provided in subdivision (b) of this paragraph—

(i) for two or more carriers to consolidate or merge their properties or franchises, or any part thereof, into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership; or for any carrier, or two or more carriers jointly, to purchase, lease, or contract to operate the properties, or any part thereof, of another; or for any carrier, or two or more carriers jointly, to acquire control of another through ownership of its stock or otherwise; or for a person which is not a carrier to acquire control of two or more carriers through ownership of their stock or otherwise; or for a person which is not a carrier and which has control of one or more carriers to acquire control of another carrier through ownership of its stock or otherwise; or

(ii) for a carrier by railroad to acquire trackage rights over, or joint ownership in or joint use of, any railroad line or lines owned or operated by any other such carrier, and terminals incidental thereto.

(b) Whenever a transaction is proposed under subdivision (a) of this paragraph, the carrier or carriers or person seeking authority therefor shall present an application to the Commission, and thereupon the Commission shall notify the Governor of each State in which any part of the properties of the carriers involved in the proposed transaction is situated, and also such carriers and the applicant or applicants (and, in case carriers by motor vehicle are involved, the persons specified in section 305(e) of this title), and shall afford reasonable opportunity for interested parties to be heard. If the Commission shall consider it necessary in order to determine whether the findings specified below may properly be made, it shall set said application for public hearing; and a public hearing shall be held in all cases where carriers by railroad are involved unless the Commission determines that a public hearing is not necessary in the public interest. If the Commission finds that, subject to such terms and conditions and such modifications as it shall find to be just and reasonable, the proposed transaction is within the scope of subdivision (a) of this paragraph and will be consistent with the public interest, it shall enter an order approving and authorizing such transaction, upon the terms and conditions, and with the modifications, so found to be just and reasonable: *Provided*, That if a carrier by railroad subject to this chapter, or any person which is controlled by such a carrier, or affiliated therewith within the meaning of paragraph (6) of this section, is an applicant in the case of any such proposed transaction involving a motor carrier, the Commission shall not enter such an order

unless it finds that the transaction proposed will be consistent with the public interest and will enable such carrier to use service by motor vehicle to public advantage in its operations and will not unduly restrain competition.

(c) In passing upon any proposed transaction under the provisions of this paragraph, the Commission shall give weight to the following considerations, among others:

(1) The effect of the proposed transaction upon adequate transportation service to the public; (2) the effect upon the public interest of the inclusion, or failure to include, other railroads in the territory involved in the proposed transaction; (3) the total fixed charges resulting from the proposed transaction; and (4) the interest of the carrier employees affected.

(d) The Commission shall have authority in the case of a proposed transaction under this paragraph involving a railroad or railroads, as a prerequisite to its approval of the proposed transaction, to require, upon equitable terms, the inclusion of another railroad or other railroads in the territory involved, upon petition by such railroad or railroads requesting such inclusion, and upon a finding that such inclusion is consistent with the public interest.

(e) No transaction which contemplates a guaranty or assumption of payment of dividends or of fixed charges, shall be approved by the Commission under this paragraph except upon a specific finding by the Commission that such guaranty or assumption is not inconsistent with the public interest. No transaction shall be approved under this paragraph which will result in an increase of total fixed charges, except upon a specific finding by the Commission that such increase would not be contrary to public interest.

(f) As a condition of its approval, under this paragraph, of any transaction involving a carrier or carriers by railroad

subject to the provisions of this chapter, the Commission shall require a fair and equitable arrangement to protect the interests of the railroad employees affected. In its order of approval the Commission shall include terms and conditions providing that during the period of four years from the effective date of such order such transaction will not result in employees of the carrier or carriers by railroad affected by such order being in a worse position with respect to their employment, except that the protection afforded to any employee pursuant to this sentence shall not be required to continue for a longer period, following the effective date of such order, than the period during which such employee was in the employ of such carrier or carriers prior to the effective date of such order. Notwithstanding any other provisions of this chapter and chapters 8 and 12 of this title, an agreement pertaining to the protection of the interests of said employees may hereafter be entered into by any carrier or carriers by railroad and the duly authorized representative or representatives of its or their employees.

Interstate Commerce Act § 13a (49 U.S.C. § 13a):

[Discontinuance or change of the operation or service of trains or ferries; notice; investigation; hearing; determination]

(1) A carrier or carriers subject to this chapter, if their rights with respect to the discontinuance or change, in whole or in part, of the operation or service of any train or ferry operating from a point in one State to a point in any other State or in the District of Columbia, or from a point in the District of Columbia to a point in any State, are subject to any provision of the constitution or statutes of any State or any regulation or order of (or are the subject of any

proceeding pending before) any court or an administrative or regulatory agency of any State, may, but shall not be required to, file with the Commission, and upon such filing shall mail to the Governor of each State in which such train or ferry is operated, and post in every station, depot or other facility served thereby, notice at least thirty days in advance of any such proposed discontinuance or change. The carrier or carriers filing such notice may discontinue or change any such operation or service pursuant to such notice except as otherwise ordered by the Commission pursuant to this paragraph, the laws or constitution of any State, or the decision or order of, or the pendency of any proceeding before, any court or State authority to the contrary notwithstanding. Upon the filing of such notice the Commission shall have authority during said thirty days' notice period, either upon complaint or upon its own initiative without complaint, to enter upon an investigation of the the proposed discontinuance or change. Upon the institution of such investigation, the Commission, by orders served upon the carrier or carriers affected thereby at least ten days prior to the day on which such discontinuance or change would otherwise become effective, may require such train or ferry to be continued in operation or service, in whole or in part, pending hearing and decision in such investigation, but not for a longer period than four months beyond the date when such discontinuance or change would otherwise have become effective. If, after hearing in such investigation, whether concluded before or after such discontinuance or change has become effective, the Commission finds that the operation or service of such train or ferry is required by public convenience and necessity and will not unduly burden interstate or foreign commerce, the Commission may by order require the continuance or restoration

of operation or service of such train or ferry, in whole or in part, for a period not to exceed one year from the date of such order. The provisions of this paragraph shall not supersede the laws of any State or the orders or regulations of any administrative or regulatory body of any State applicable to such discontinuance or change unless notice as in this paragraph provided is filed with the Commission. On the expiration of an order by the Commission after such investigation requiring the continuance or restoration of operation or service, the jurisdiction of any State as to such discontinuance or change shall no longer be superseded unless the procedure provided by this paragraph shall again be invoked by the carrier or carriers.

(2) Where the discontinuance or change, in whole or in part, by a carrier or carriers subject to this chapter, of the operation or service of any train or ferry operated wholly within the boundaries of a single State is prohibited by the constitution or statutes of any State or where the State authority having jurisdiction thereof shall have denied an application or petition duly filed with it by said carrier or carriers for authority to discontinue or change, in whole or in part, the operation or service of any such train or ferry or shall not have acted finally on such an application or petition within one hundred and twenty days from the presentation thereof, such carrier or carriers may petition the Commission for authority to effect such discontinuance or change. The Commission may grant such authority only after full hearing and upon findings by it that (a) the present or future public convenience and necessity permit of such discontinuance or change, in whole or in part, of the operation or service of such train or ferry, and (b) the continued operation or service of such train or ferry without discontinuance or change, in whole or in part, will constitute

an unjust and undue burden upon the interstate operations of such carrier or carriers or upon interstate commerce. When any petition shall be filed with the Commission under the provisions of this paragraph the Commission shall notify the Governor of the State in which such train or ferry is operated at least thirty days in advance of the hearing provided for in this paragraph, and such hearing shall be held by the Commission in the State in which such train or ferry is operated; and the Commission is authorized to avail itself of the cooperation, services, records and facilities of the authorities in such State in the performance of its functions under this paragraph.

Judiciary Code, § 2072 (28 U.S.C. § 2072):

[Rules of civil procedure for district courts]

The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases, and appeals therein, and the practice and procedure in proceedings for the review by the courts of appeals of decisions of the Tax Court of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.

Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution.

Such rules shall not take effect until they have been reported to Congress by the Chief Justice at or after the beginning of a regular session thereof but not later than the

first day of May, and until the expiration of ninety days after they have been thus reported.

All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect. Nothing in this title, anything therein to the contrary notwithstanding, shall in any way limit, supersede, or repeal any such rules heretofore prescribed by the Supreme Court.

Maine Public Utilities Act § 15 (35 M.R.S.A. § 15):

[Definitions]

3. Common Carrier. "Common carrier" includes every railroad company, express company, dispatch, sleeping car, dining car, drawing-room car, freight line, refrigerator, oil, stock, fruit, car loaning, car renting, car loading and every other car corporation or person, their lessees, trustees, receivers, or trustees appointed by any court whatsoever, operating for compensation within this State; and every corporation or person, their lessees, trustees, receivers or trustees appointed by any court whatsoever, owning, controlling, operating or managing any vessel regularly engaged in the transportation of persons or property for compensation upon the waters of this State or upon the high seas, over regular routes between points within this State.

13. Public utility. "Public utility" includes every common carrier, gas company, natural gas pipeline company, electrical company, telephone company, telegraph company, water company, public heating company, wharfinger and warehouseman, as those terms are defined in this section, and each thereof is declared to be a public utility and to be subject to the jurisdiction, control and regulation of the commission, and to chapters 1 to 17.

14. Railroad. "Railroad" includes every commercial, interurban and other railway and each and every branch and extension thereof by whatsoever power operated, together with all tracks, bridges, trestles, rights-of-ways, subways, tunnels, stations, depots, union depots, ferries, yards, grounds, terminals, terminal facilities, structures and equipment and all other real estate, fixtures and personal property of every kind used in connection therewith, owned, controlled, operated or managed for public use in the transportation of persons or property.

15. Railroad company. "Railroad company" includes every corporation or person, their lessees, trustees, receivers or trustees appointed by any court whatsoever, owning, controlling, operating or managing any railroad for compensation within this State.

RESPONDENT'S BRIEF

APPENDIX B

REPORT TO THE COMMISSION

**REVIEW OF DIVERSIFIED HOLDING COMPANY
RELATIONSHIPS AND TRANSACTIONS OF
BANGOR PUNTA CORPORATION**

**BUREAU OF ACCOUNTS
INTERSTATE COMMERCE COMMISSION
FEBRUARY 1971**

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REVIEW OF DIVERSIFIED HOLDING COMPANY RELATIONSHIPS AND TRANSACTIONS OF BANGOR PUNTA CORPORATION

HIGHLIGHTS

PURPOSE OF THE REVIEW

The purpose of the review was to explore the impact of the Bangor Punta Corporation on the Bangor & Aroostook Railroad while it was owned by and under the control of this diversified holding company and to determine whether or not the intercompany relationships and resulting financial transactions were detrimental to the carrier.

FINDINGS AND CONCLUSIONS

There were numerous instances found where management and control of the carrier's assets by the holding company proved detrimental to it. The principal findings are:

- ... Carrier's assets were removed through payment of management fees, questionable dividend practices, and transfers of marketable securities which contributed to a cash problem.
- ... Carrier received no credit for its operating losses and investment tax credits contributed to the consolidated federal income tax return.
- ... Carrier denied investment opportunities because of holding company restrictions on its use of cash.
- ... Carrier's costs were increased through improper allocation of expenses and the performance of clerical services.

- . . . Holding company expansion objectives were enhanced through diversion of carrier assets and use of its management talent.
- . . . Holding company, although showing a loss of \$13 million in press releases, actually realized a net cash gain when it disposed of its investment in the carrier.

In the context of this study, it is clear that when a holding company obtains control over a carrier, transportation management takes a "backseat" and serving the public interest is a secondary consideration.

RECOMMENDATIONS

We recommend that all legal remedies be explored to require the holding company, which sold the carrier, to pay back to the carrier for assets taken with no compensation and charges made where no services were performed.

INTRODUCTION

The Bureau of Accounts has made a review of selected financial transactions of the Bangor & Aroostook Railroad Company (carrier). The highlights of this review are shown in the preceding section of this report.

This examination was a followup to our preliminary findings which were reported in our Special Review of Railroad Conglomerates dated March 11, 1969.

Since that report was made, Bangor Punta Corporation sold its stock ownership in the carrier on September 30, 1969 to Amoskeag Company (Amoskeag), an investment company. For information on Amoskeag see Appendix IV.

In our report of March 11, 1969 we commented in Section VI POTENTIAL QUESTIONABLE PRACTICES that:

"2. Divestiture of railroad

A railroad's position in the conglomerate group becomes less important as the holding company grows financially. For example, Bangor Punta's annual report to stockholders for the year ended September 30, 1968 showed that the Railroad's contribution to revenues was 19 percent in 1964 and only 6 percent in 1968. In the same period, the contribution to consolidated profits declined from 22 percent to 1 percent. In such situation, a holding company might be inclined to dispose of a railroad after having used it advantageously.

"This situation would prevail where a holding company would dispose of a carrier after it had utilized all tax benefits, sold all valuable assets, and also under maintained the plant. In fact, a holding company might be forced to do this, as a result of stockholder demands, when a carrier shows operating losses for a few years."

The Commission also has before it an application of the North Western Employees Transportation Corporation for authority to purchase and operate the Chicago and North Western Railway Company, which is controlled by Northwest Industries.

Further in our report of March 11, 1969 in our conclusions we stated:

"We recognize there are many railroad officials who contend that corporate diversification is the answer to their financial problems. The results of the staff's audit, although limited, indicate that one of the shining examples of benefits of corporate conglomerate arrangements may be slightly overstated.

"Bangor Punta group has often been cited by those in favor of railroad diversified holding companies as an example of the railroad receiving benefits from a hold-

ing company relationship. The claims were based on the premise that Bangor & Aroostook Railroad service is better because of the capital available for its activities from Bangor Punta, which would not ordinarily be available to the Railroad. This allegedly resulted in an overall improved financial condition of the Railroad.

"Our review disclosed the contrary. The Railroad has been contributing funds to the holding company by payment of special dividends; lending funds at rates below prevailing interest rates; using Railroad's credit; and by borrowing funds at local banks to pass on to the holding company.

"Regardless of all the glowing self-serving statements made in current merger proceedings, our belief is that when circumstances warrant, these managements will involve the railroads in similar transactions. For certainly, holding company managements, in addition to their own strong self-interests will owe their allegiance to the stockholders of the holding company and not to the railroad or any individual part of the conglomerate."

The findings and conclusions in our report also include some of those contained in a staff report on "Conglomerate Merger Activity" dated March 31, 1969, and in legislative proposals recently submitted to the Congress.

The text of this report identifies problem areas, our proposals to correct them, and the details of each questionable practice.

This is the initial report submitted concerning the sale of a carrier involved in a diversified holding company arrangement. In it we have attempted to demonstrate the effect of the stewardship of the holding company on the carrier and of the resultant limitation placed on the ability of the car-

rier to carry out its transportation responsibilities to the public where its parent holding company is not wholly committed to the transportation needs of the public.

A brief history of the carrier's involvement in a diversified holding company relationship indicates that a management consultant was engaged to launch the carrier into profitable diversified activities. As a result of management's interests in activities other than transportation, Nicolas Salgo was engaged to assist it in this diversification program. The details of Mr. Salgo's involvement with the carrier are shown in Appendix V.

A summary of Mr. Salgo's activities is as follows:

- ... he was engaged at a salary of \$12,000 per year, plus stock options.
- ... he then advised the carrier to form a holding company to accomplish its diversification program. The carrier thereupon created Bangor & Aroostook Corporation on December 1, 1960.
- ... he then advised the newly organized holding company (Bangor & Aroostook Corporation) to acquire a corporation in which his family had a considerable stock investment.
- ... he advised the carrier to merge its holding company (B&A Corp.) with a holding company controlled by his interest, Punta Alegre Sugar Corp. This was accomplished on October 13, 1964.
- ... certain key officials of the carrier were given bonuses and salary increases. For example, the salary of Mr. Robertson, Chairman of the Board of the B&A Corp., was increased from \$36,000 to \$100,000.

After using carrier resources such as:

- management talent
- cash

declaration of special dividends
current tax benefits
relieving it of possible future tax benefits

The carrier was sold by the holding company to Amoskeag Company, an investment firm.

In four years, Mr. Salgo obtained control of the carrier and its resources. The carrier was subsequently disposed of when it failed to meet Punta's corporate objective which was to secure the highest possible rate of return on investment.¹

There is no evidence to indicate that any concern or consideration was at any time given to the responsibility of the carrier to the public. The entire transaction, in our judgment, from its inception to the ultimate sale of the carrier served the objectives of Punta.

We searched for benefits from the carrier's relationship with this diversified holding company group. We were unable to determine any instance which would show any transaction which was conceived for the benefit of the carrier. Because this was the initial case where a carrier was sold by a diversified holding company, the question of any possible benefits derived from the carrier's participation in a conglomerate arrangement was discussed with carrier management. We asked carrier officials — what benefits did the carrier receive from the holding company? How did they help you? One of the officials of the carrier responded by indicating the Punta group "used our talent — provided

¹ From Annual Report (to shareholders) for the year ended Sept. 30, 1968: "In accordance with our policy of continuously reviewing the return on investment which our operations produce, we determined that our Pacific Coast foundry operation was not meeting our corporate goals and it was disposed of during the year." A similar determination was made with respect to the Bangor & Aroostook Railroad within the following year.

none, they used our credit, cash and financial ability." He further indicated that he could not give any specific benefits the carrier derived — but one — they sold us to Amoskeag. In connection with this statement, it would be well to consider in conjunction therewith, the remarks embraced in a memorandum subject "Post Sale Comments," page 32 of this report. Another top management official responded by stating that ownership by Amoskeag was a definite "plus," that the carrier had been the "underdog" in the Punta group. While the latter official declined to criticize, he was silent with regard to any benefits derived from Punta. Both officials were enthusiastic about the change in ownership.

Mr. W. Jerome Strout, carrier President and former Vice President and Director of Punta, in responding to a request for his opinion of the impact that Punta had on the carrier pointed out in a carefully worded statement dated 9/18/70; that the sale will benefit both employees and customers and that the change in ownership will result in the availability of financial assistance and railroad know-how which "would not be available if the railroad were still owned by one thousand odd stockholders."¹ Mr. Strout stressed the benefits of change in ownership and made no reference to benefits received from Punta.

In an article appearing in *Railway Age* on April 21, 1969, Mr. Jervis Langdon, Jr., who is now a trustee of the Penn Central Transportation Co. and who was then Chairman and President of the Chicago, Rock Island and Pacific Railroad Co., expressed some of the staff's conclusions on carrier involvement with diversified holding companies.

"The principal reason for my doubt is that railroads with earnings from conglomerates may find it easier to avoid the tough decisions that are necessary to solve

¹ Reference is made to Punta stockholders.

the railroad service problem — and the service problem must come ahead of everything else, even earnings.' ”

He also commented :

“ ‘I realize that lack of capital for improvements running into the billions has a direct bearing upon the railroad service problems, and that conglomerates, with their promise of greater earnings and financial strength, should be able to help in this connection. But would they really help when the choice is between a railroad investment which produces a small return and another investment which promises a much greater return? I wonder to what extent conglomerates, with earnings from diverse sources, can afford to pump into their railroad subsidiaries the kind of money that is required, particularly when there are so many attractive investment opportunities outside the railroad business.

“In the final analysis, he said, there must be recognition that ‘the railroad service problem is tough and calls for heroic measures. Only the full and undivided attention of the first team of railroad management, with a willingness truly to cooperate, can possibly come to the rescue. The problem will never be solved if it is regarded as only another routine problem for someone else to worry about while the first management team is preoccupied with more acquisitions for the conglomerate and more earnings for non-transportation sources.

‘And if the service problem is not solved, the shippers of the country, finally losing all patience, will demand a change, and what change can there be other than nationalization even though nationalization has not always been a satisfactory answer in other countries? Moreover, if the railroads in the meantime have

become conglomerate subsidiaries, a government takeover might be highly welcome. In the history of our country there have been many instances of the spinning off by private enterprise of public service undertakings, and they have invariably ended up in public ownership. There is ample precedent in our own country for the public ownership of railroads.' "

The above quote from Mr. Langdon summarizes many of the problems encountered with our review of railroad involvement with diversified holding companies.

RECOMMENDATIONS

The Bureau of Accounts believes that the policies, practices and procedures carried out by the holding company were not in the best interest of a viable transportation system. In no instance in the conduct of management can we find where the interest of the carrier held precedence over that of Bangor Punta Corporation.

We believe that the recommendations contained in the staff report on "Conglomerate Merger Activities" dated March 31, 1969, would prevent many of the practices considered detrimental to the carrier's ability to provide an efficient transportation service.

Specific Recommendations With Regard To Punta

That Punta be required to make restitution of assets taken from the carrier with respect to three items: (1) That action be taken against the carrier with regard to requiring Punta to pay back the \$528,000 in management fees or so-called corporate charges paid to Punta for which the carrier derived no benefit.

(2) That action be taken to require Punta to pay back to the carrier \$63,535, which was the amount of overpayment.

to Punta in connection with a tax deficiency assessment described under caption Special Corporate Charges.

(3) That similar action be taken against the carrier to require that Punta make payment to the carrier for benefits totaling approximately \$3.2 million derived from the carrier's contribution as a participant in the consolidated federal income tax returns (including interest thereon to be computed at prime interest rates).

While recognition is given to the adverse effect of such restitution on Punta's stockholders, and the apparent gift to Amoskeag's stockholders, our primary concern is that carrier assets remain with the carrier for use in maintaining or improving its transportation service to the public. In connection with any such repayment, adequate safeguards should be established to ensure that the funds remain with the carrier and are not removed by the new owners through the dividend route or by any other method. Such safeguards would have to be established prior to any action taken.

In the text of this report, we have indicated the actions believed necessary to control questionable practices disclosed herein. Generally, these include the following:

(1) That contractual arrangements regarding management fees be reported to the Commission for approval, and that all details of such arrangements be disclosed in reports to the Commission.

(2) That special dividend proposals be submitted to the Commission for prior approval.

(3) That intercompany transactions which result in a transfer of assets from the carrier or its subsidiaries to other members of the group require Commission approval.

(4) That agreements respecting the method of allocating tax liability between participants in a consolidated return be reported to the Commission for its approval, and where

such agreements are not in the public interest the carrier will not be able to participate in the filing of a consolidated return; and that the amount of contributions or reimbursement received by the carrier be fully disclosed in reports to the Commission.

(5) That Commission approval be a prerequisite to all plans that place control of carrier's cash and other assets in the hands of the holding company.

We recommend also that appropriate steps be taken to require Punta to make its 1969 consolidated federal income tax return and working papers¹ available for inspection to Commission representatives.

Finally, we recommend that new regulations be established to prevent diversion of management talent and diversion of assets, to the extent that carriers be precluded from participating in conglomerate activities where such activities cannot be clearly shown to be in the public interest.

Because of our further review of diversified holding companies, the Bureau now firmly believes that to avoid further erosion of the public transportation service, the companies providing such service should engage in that service alone, and devote their entire energies to that objective. Otherwise, the more lucrative return on investment which may be available outside of the transportation industry may serve to lure away the funds and the dedication of individuals to other more remunerative ventures, using carrier funds where available, to the detriment of the entire transportation industry's ability to provide service to the public.

SCOPE OF REVIEW

The primary emphasis of the review was on evaluating the effect of Punta's policies, procedures, and practices on

¹ Tax return prepared subsequent to current review of accounts.

the carrier as a transportation company, as manifested in the intercompany financial transactions.

Our review was conducted at the offices of the Bangor & Aroostook Railroad (carrier) and the Bangor Punta Corporation (Punta) at Bangor, Maine, on two separate occasions. Records reviewed included the accounting and financial records of Punta for the period October, 1964 through 1968, and the carrier's records for the period 1960 through 1969.

The holding company records maintained at Bangor, Maine, were made readily available for inspection during the initial review. When the final review was conducted, the holding company had disposed of its investment in the carrier; consequently, the holding company's records had been removed and were no longer accessible.

QUESTIONABLE PRACTICES CORPORATE CHARGES

PROBLEM

Substantial sums of cash were transferred to the holding company as "corporate charges." These charges were not based on services performed, but upon the apparent requirements of the holding company in obtaining cash from the carrier.

RECOMMENDATIONS

That carriers be required to report contractual arrangements for management services entered into with affiliates, disclosing such details as types of services, basis of charges, and amounts charged carrier and other members of the group to the Commission for approval. Further, that Punta be required to reimburse the carrier \$528,000 in corporate charges paid between October, 1964 and July, 1967.

DETAILS

Corporate charges were initiated by Bangor & Aroostook Corporation (B&A Corp.), the first holding company, for the purpose of providing cash with which to pay holding company expenses, such as legal, accounting, printing, salaries and wages, and travel. Allegedly these charges were allocated between companies. There was no adequate support for the amount allocated to the carrier. The carrier was notified of such assessment by one of its officials early in 1962 as follows:

"It has been requested that Bangor and Aroostook RR be billed by B. A. C. for its share of services. For this year our share will be \$105,400.00. Will you please accrue this monthly commencing with April 1962 at the rate of \$11,711 per month. Charge to 551 (Miscellaneous Income Charges). You will be billed by B. A. C. quarterly with the first bill coming at the end of June."

In practice, the carrier used its cash to pay the holding company's bills. Amounts paid in this manner were applied against the corporate charges. During the period of ownership by B&A Corp., the carrier paid approximately \$282,000 to satisfy the cash requirements of that holding company with no discernible benefit to the carrier.

Effective with the merger into Punta (October 1964), the carrier was required to pay Punta an arbitrary amount of \$13,000 per month for the first 12 months, \$16,000 per month for the second 12 months, and \$20,000 per month for the final 9 months before such charges were discontinued. Cash payments totaling \$528,000 were made to the holding company (Punta) between October, 1964 and June 1967.

Corporate charges or management fees totaled \$810,000, including \$282,000 paid to B&A Corp. (former holding company) and the \$528,000 paid to Punta. These payments

were recorded in carrier's account 551, Miscellaneous Income Charges, indicating that it recognized these payments were not proper charges to transportation operating expense and not properly includible for rate case determination. Nevertheless the cash was paid by the carrier.

No specific details were available to support the amounts assessed. Carrier and holding company (Punta) officials described the payments as being for general management, such as legal and audit services. Punta's chief accounting officer stated that he had no knowledge of how the arbitrary charges were established or why such billings were discontinued.

The carrier received a separate bill from Peat, Marwick, Mitchell & Co., independent accountants, for audit services for the fiscal year ended September 30, 1967, in the amount of \$9,714, which was \$10,286 less than one month's assessment of \$20,000. This indicates that the so-called corporate charges or management fees were far in excess of the amount needed to cover the cost of services provided.

Further, the carrier employs its own legal department and counsel. Therefore, with the possible exception of tax advice, the carrier had little or no need for legal services purportedly provided by holding company. Our investigation disclosed that the carrier was providing legal services to Punta.

Instructions to discontinue the charges were transmitted to the carrier's accounting department by President Strout in a memorandum dated August 8, 1967. No representative of the carrier has been able to support or demonstrate the services received for these expenditures.

SPECIAL CORPORATE CHARGES

PROBLEM

The carrier was required to pay the holding company an additional \$158,794 in connection with a tax deficiency that resulted from an Internal Revenue Service (IRS) audit of consolidated federal income tax returns. Payment was passed on to the carrier despite the fact that only a portion of the tax deficiency assessment related to items pertaining to the carrier.

RECOMMENDATION

Require Punta to reimburse the carrier \$63,535 for that portion which was not a liability of the carrier.

DETAILS

In August, 1967, \$158,794 was paid to Punta through a transfer of cash from the carrier's account to the account of Bangor Punta Operations, Inc. (a 100% owned subsidiary of Punta), at the Franklin National Bank, New York, New York. This payment, charged to carrier's account 797, Retained Income - Appropriated, was based on the computation of a tax deficiency assessed against Punta after an IRS audit of the consolidated tax returns of the former Bangor & Aroostook Corporation for the years 1960 through 1963. The carrier and its subsidiaries participated in these consolidated returns along with other companies. In October, 1964, the assets and liabilities of B&A Corp. were merged into Bangor Punta Corp., and the B&A Corp. subsequently was liquidated.

The total deficiency assessment was \$158,794.00 to which was added interest amounting to \$53,161.47, making the total liability due the IRS \$211,955.47. The controller of the carrier, explained that since the interest was a tax de-

ductible item, for the benefit of Punta, the carrier was not required to pay that amount to Punta. On a worksheet dated May 28, 1968, which he prepared, the deficiency was allocated as follows:

	Liability		
	Tax	Interest	Total
Carrier and subsidiaries	\$ 46,421.00	\$48,838.31	\$ 95,259.31
Bangor Punta Operations	112,373.00	4,323.16	116,696.16
Total Assessment	\$158,794.00	\$53,161.47	\$211,955.47

The interest expense of \$48,838.31 allocated to the carrier, but not actually paid by it, seems disproportionate to the amount assigned to the holding company of \$4,323.16. It was not possible to verify these figures as Punta had sold the carrier and the necessary records were not available to us. In connection with the deficiency tax assessment, the controller stated that the IRS required the carrier to capitalize for tax purposes certain items that the carrier had recorded in its operating expense accounts in accordance with the Commission's accounting rules.

However, this accounted for only a portion of the total tax deficiency; the remainder resulted from the disallowance of items attributable to other companies participating in the consolidated return. Punta, in allocating the deficiency, charged the entire amount to the carrier. To require the carrier to make full restitution to the holding company of the entire deficiency, when only a portion was attributable to the carrier is not just or reasonable. The controller indicated this on his worksheets when he referred to the difference between the amount the carrier paid of \$158,794 and what he computed to be the carrier's liability of \$95,259 as a "cash deficiency" of \$63,535.

As pointed out above, the allocation of the total amount of the interest included in the assessment is also questionable. Consequently, any reduction of that figure would further reduce the carrier's total liability and at the same time it would increase the amount to be paid the carrier by Punta.

DIVIDEND PRACTICES

The staff encountered several problems in its analysis of dividends. These are shown below in two sections.

PROBLEM — A

Carrier's cash was transferred to B&A Corp. through a special dividend declared immediately prior to the merger of B&A Corp. into Punta. B&A Corp., as majority stockholder, received approximately 90% of the dividend.

DETAILS

On the effective date of merger with the Punta group, October 13, 1964, the railroad declared and paid a special cash dividend of \$2.60 per share. The B&A Corp., owner of approximately 90% of the outstanding capital stock of the carrier, was the principal recipient. In the final liquidation of B&A Corp., cash in the amount of \$336,978.75 was transferred to Punta. Thus, in the final analysis, Punta acquired most of the dividend through its control over B&A Corp. Therefore, Carrier's net worth was reduced to provide working capital to the holding company.

PROBLEM — B

Carrier assets were transferred to Punta through a dividend plan formulated by it to cancel certain of its debt obligations to the carrier.

RECOMMENDATION

That carriers involved in diversified holding companies be required to submit to this Commission for its approval details of all special dividends proposed to be paid, particularly when the holding company is the principal beneficiary.

DETAILS

In brief, the plan provided for the carrier to declare special dividends that would serve to improve the appearance of the holding company's balance sheet by eliminating debt due to the carrier.

Between December, 1960, and October, 1964, the carrier was owned by the Bangor & Aroostook Corporation (B&A Corp.). Effective October 13, 1964, the latter corporation was merged into Bangor Punta Corporation. Bangor Punta Operations, Inc., a subsidiary company, subsequently acquired ownership of the carrier in 1967. As a result of the merger, Punta assumed obligations of the B&A Corp., including interest bearing promissory notes due the carrier aggregating \$602,000 and an interest bearing note in the amount of \$585,700 payable to the Bangor Investment Co., a 100% owned affiliate of the carrier.

In July, 1966, Punta formulated a policy whereby the carrier would declare special dividends in addition to the regular dividend. Since Punta owned 98.9% of the carrier, the special dividends were not to be paid in cash, except to minority stockholders. Instead, Punta's share was to be paid "in kind," i.e., applied to reduce the note with the intention of eventually eliminating the debt entirely. The plan called for special dividends by carrier in each of the calendar years 1966, 1967, and 1968, in the per share amounts of \$2.50, \$2.50, and \$1.70, respectively.

The 1966 special dividend reduced the holding company's debt to the carrier (\$602,000.00) by \$443,227.50, leaving a balance due of \$158,772.50.

On January 27, 1967, Bangor Investment Co., declared a dividend of \$585,700 to its parent, the carrier, giving it the note in amount of \$585,700 due from Punta. Simultaneously, the carrier declared a special dividend of \$2.50 of which \$443,340 was applied to the note due from Punta, leaving a balance due of \$142,360. In the final analysis, the two special carrier dividends reduced Punta's debt to the carrier from \$1,187,700 to a balance of \$301,132.50.

The planned special dividend program for the carrier was not completed as its earnings declined in 1968 because of a poor potato crop. Through the declaration of 1966 and 1967 special dividends, and poor earnings in 1968, retained income of carrier was reduced to an amount below which dividends could be paid under the restrictive provisions of carrier's mortgage. Because of these indenture dividend restrictions and continued low earnings no dividends were declared after 1967.

These dividend practices imposed on the carrier by Punta were planned to improve the balance sheet of the holding company and eliminate its interest payments to the carrier. As a result of this program, the carrier's net worth and income were reduced through transfer of assets to the holding company. Conversely, the holding company reduced its liabilities and interest expense and correspondingly increased its net worth, all to the detriment of the carrier.

MARKETABLE SECURITIES

PROBLEM

Marketable securities of a carrier subsidiary, Bangor Investment Co., were transferred to the holding company through a series of complex proceedings. The holding com-

pany acquired these securities with only a nominal outlay of cash, and subsequently realized substantial cash gains in the final liquidation for use in its expansion program.

RECOMMENDATION

That Commission approval be required for all such inter-company transactions to prevent the possible dissipation of assets by holding companies, and further that the carrier be required to make full disclosure of such transactions in its annual report to the Commission.

DETAILS

Prior to control of carrier by the B&A Corp., the Bangor Investment Company, a 100% owned subsidiary of the carrier, purchased St. Croix Paper Co. common stock as an investment at a cost of \$2,127,000. The money to acquire the stock was borrowed from the carrier, except for \$200,000 borrowed from the First National Bank of Boston and secured by 12,000 shares of the stock.

In December, 1960, B&A Corp. acquired ownership of the carrier and its subsidiaries. In September, 1962, the directors of the carrier approved the sale of the St. Croix stock to the holding company for a total of \$2,127,000, the price paid on acquisition by the carrier's subsidiary. Payment was arranged as follows:

- (a) B&A Corp. to assume the liability for the note payable to the First National Bank of Boston in the amount of \$200,000.
- (b) B&A Corp. to issue 15,000 shares of preferred stock, par value \$100.00 per share, to be distributed; 10,180 shares to carrier and 4,820 shares to Bangor Investment Co.
- (c) B&A Corp. to issue a new note to carrier in the amount of \$427,000 bearing interest at 4½%.

The preferred stock and notes issued to the carrier represent replacement of notes totaling \$1,445,000 payable to carrier by the Bangor Investment Co. In other words, Bangor Investment Company's liability to the carrier was transferred to B&A Corp.

Within four months after the B&A Corp. acquired the St. Croix stock, it was exchanged for 54,231 shares of Georgia Pacific stock, resulting in an increase of \$585,700 in value. Since the St. Croix stock was disposed of in less than six months after acquisition by B&A Corp., B&A Corp. issued its promissory note in that amount to Bangor Investment Co. as per an agreement entered into at the time of the transfer. However, \$443,340 of this amount was immediately returned to B&A Corp. in the form of dividends. This was previously commented on the section entitled Dividend Practices.

In 1964, the B&A Corp. reacquired its preferred stock by transferring ownership of 27,735 shares of the Georgia Pacific stock to the carrier at its market value, \$1,554,114, representing an excess of \$54,114 over the par value of the preferred stock reacquired. The carrier paid the B&A Corp. this difference of \$54,114 in cash, and additional cash of \$14,800 for 276 additional shares for a total of \$68,914.

Of the total number of shares of Georgia Pacific stock acquired through the exchange, 54,231 shares, and through stock dividends, the B&A Corp. held 33,925 shares and the carrier 28,856 shares. B&A Corp. then sold to outside parties its remaining shares during the years 1963 and 1964, for \$1,926,148.

To summarize the preceding details, the B&A Corp. required Bangor Investment Company to transfer its investment in the St. Croix stock to the holding company, and was able to acquire a substantial sum of cash. This also enabled

the holding company to realize a net profit of \$782,362 within a two-year period from a cash investment of only \$501,132.50. The balance of its investment cost was satisfied through paper transactions with the carrier and its subsidiary. B&A Corp., thereby, was supplied with cash to use in its diversification program.

The following schedule shows the various proceeds and gains to the holding company:

Cash Proceeds to B&A Corp. from sale
of Georgia-Pacific stock:

From sale to carrier	\$ 68,914.00
From sale to others	1,926,148.00
Total Cash received	<u>\$1,995,062.00</u>

Cost to B&A Corp.

Cash cost:

Bank note paid	\$ 200,000.00
Cash paid carrier on notes issued	301,132.50

Noncash cost (notes issued and
liquidated through paper transactions):

Note #324	
(to railroad)	\$ 427,000.00
Note #334	
(to invest. co.)	585,700.00
	<u>\$1,012,700.00</u>

Less cash paid
to carrier

(per above)	301,132.50	711,567.50
	<u></u>	<u>\$1,212,700.00</u>

Gain on sale

\$ 782,362.00

In addition to the above gain of \$782,362, the holding company also received cash dividends from the ownership of the stock. The impact on the carrier of this transaction is that the carrier's affiliate lost the potential gain from the sale of securities that could have been realized had the assets been retained by the affiliate. Conversely, the holding company acquired substantial sums of cash through disposition of the stock for use in its expansion program. Consideration also should be given to the following:

- (a) B&A Corp. had no cash at time of purchase and had to rely on future ability to pay the seller.
- (b) Investment Co. had no need to dispose of the investment, i.e., it did not need cash.

FEDERAL INCOME TAXES

PROBLEM

The carrier contributed substantial benefits in the form of its operating losses and investment tax credits to the consolidated federal income tax return filed by the holding company. The carrier was not reimbursed for any of its contributions and further, these tax losses are not available to offset future taxable gains.

RECOMMENDATION

(a) Require carriers desiring to participate in consolidated tax returns to file with the Commission the basis and details of the method to be used in allocating the tax liability; and where such allocations are not in the public interest that the holding company be denied the inclusion of the carrier in its consolidated return.

(b) That the amount of tax benefits contributed by a carrier and its subsidiaries, and the policy regarding re-

imbursement, be disclosed in the annual report to this Commission.

DETAILS

Federal income taxes were computed on a separate return basis by the carrier and its subsidiaries, without benefit of operating loss carry-overs or investment credits. The results were submitted to Punta for inclusion in its consolidated return. Summarized below are the carrier's tax operating losses and investment credits which were made available to Punta for the consolidated return.

Year Ended Sept. 30	Taxable Income or Loss		Investment Tax Credit
	Carrier	Carrier & Subs	
1964			\$ 280,509
1965	\$ 457,806	\$ 818,160	532,562
1966	(597,017)	(139,173)	496,025
1967	(1,200,631)	(1,147,289)	4,369
1968	(1,395,418)	(1,428,090)	253,322
1969	(1,486,218)	(1,496,133)	14,285
	<u>(\$4,221,478)</u>	<u>(\$3,392,525)</u>	<u>\$1,581,072</u>

Carrier operating losses resulted largely from use of accelerated depreciation methods, previously adopted for tax purposes. Substantially all of the investment credits available to the holding company were contributed by the carrier. In evaluating the benefits, a rate of 48% was applied to the taxable losses of the railroad and its subsidiaries.

As a result of the tax practice imposed on the carrier, Punta received tax benefits totaling approximately \$1.6 million from operating losses (48% of taxable losses of \$3,392,525). Punta apparently was able to make full use of this benefit prior to sale of carrier, because it went into a tax paying position in 1968 and 1969. No provision was

made to reimburse the carrier for any portion of the amounts contributed by the carrier which are now not available to the carrier when it shows profit.

The total investment tax credit was used by Punta. There was no unused portion at date of sale (10/1/69).

Therefore, had the carrier not passed the operating losses on to its parent, the carrier would have been able to carry the losses forward to offset possible future profits. With no carry-overs left, future profit-making years will result in an immediate tax liability.

The holding company required the carrier to continue the accelerated depreciation method because if the carrier's interest had been considered, it would have initiated action to change over to a slower write-off, such as the straight-line method, to conserve these tax reductions to offset against profitable years of operation. The carrier had no tax liability of its own and carrier profits had declined; therefore, it would have been in the best interest of the carrier to defer the expense for future years, when conceivably it would be of more value to the carrier. The continued application of accelerated depreciation served the best interest of the holding company to the detriment of the carrier.

Loss carry-overs and other tax credits are valuable assets. Without the loss carry-overs, a tax liability will require the expenditure of carrier funds.

USE OF CARRIER'S CASH

PROBLEM

Punta imposed a restrictive policy on the use of the carrier's cash to satisfy Punta's corporate needs. This restriction prevented carrier from investing its excess cash and realizing income from such investments.

RECOMMENDATIONS

We recommend that Commission approval be required for any use or control of carrier's cash and that the holding company be required to demonstrate the benefits accruing to the carrier from such use. This requirement would prevent the holding company from imposing restrictive controls over the carrier's cash.

DETAILS

A loan agreement between Punta and its lending banks provided for compensating balances to be maintained. That agreement permitted Punta to take credit for carrier's cash balances. To satisfy the terms of the agreement, the carrier was required to maintain cash deposits larger than necessary to meet its own needs. When the average monthly deposits exceeded \$1,344,000, carrier was paid interest at the rate of 3% per annum on the excess, a rate considerably below the prevailing interest yield. Perhaps more important, however, was the fact that the holding company exercised control over the carrier's cash at its own discretion, with no restrictions and with no concern about adequate compensation to the carrier.

CASH ADVANCES

PROBLEM

The carrier made frequent cash advances to satisfy the demands of Punta. Although compensated at prevailing interest rates, the carrier was required to keep cash readily available or borrow, if necessary. Controls of this nature could reduce the carrier's future borrowing capabilities, and impair its ability to maintain a viable transportation system.

RECOMMENDATIONS

That the indiscriminate use of carrier's funds be discouraged by requiring Commission approval for all advances made to the holding company or to other non-carrier companies in the group.

DETAILS

Advances and repayments are scheduled below in total by years. They were made at frequent intervals within each year.

Year	Total Advanced	Total Repayment
1965	\$2,100,000.00	\$1,700,000.00
1966	2,050,000.00	2,450,000.00
1967	800,000.00	800,000.00
1968	2,200,00.00	2,200,000.00
1969	— 0 —	301,132.00

With respect to the 1968 advances, it was necessary for the carrier to borrow \$1,700,000.00 for which it received $\frac{1}{4}$ of 1% interest over that paid to the lending bank.

Although interest earnings on these advances were in accordance with prevailing rates, the advances restricted the carrier from using its funds in the development of its transportation properties, and further, restricted the carrier from investing its excess cash where it could provide a higher return from growth as well as through interest or dividends.

ACCOUNTING AND CLERICAL SERVICES PERFORMED FOR HOLDING COMPANY AND CARRIER'S SUPPORTING RECORDS

PROBLEM

During the period of ownership by B&A Corp., that holding company used carrier employees and office facilities to

perform its administrative functions, at carrier expense. To absorb the extra work, and minimize carrier expense, short-cut methods and procedures were adopted out of necessity. This resulted in voids in carrier's records of that period and seriously hampered the current review. The extent to which short-cut methods were used has placed carrier in violation of general instruction 1-3, Records, of the Commission's prescribed accounting regulations because entries are not supported by such detailed information as will permit ready identification, analysis and verification of all facts relevant thereto.

RECOMMENDATIONS

That all arrangements for management services, including use of carrier personnel and facilities, be covered by contractual arrangements requiring Commission approval; that the holding company demonstrate that the carrier will be adequately compensated for the use of its resources; and that these arrangements be fully disclosed in detail in annual reports to this Commission.

DETAILS

Carrier personnel were required to perform all clerical and accounting services for the B&A Corp. from 1960 until merger with Punta group in 1964. Being a small carrier, it normally maintains a relatively small office staff. The employee who prepared invoices for B&A Corp., or for the carrier, covering inter-company transactions, also was the same person who prepared vouchers or journal entries in settlement thereof. Consequently, only one set of documents was prepared to support inter-company transactions. In many instances, those documents were filed as holding company records. When the holding company files were turned

over to the Punta group, the carrier was left without adequate support for entries in its accounts. When Punta sold its interest in the carrier, access to any of Punta's records was entirely eliminated. For this reason, the carrier's records do not contain any support for entries made in connection with the so-called "corporate charges" referred to in another section of this report. (See Appendix VIII)

BONUSES — SALARY INCREASES OF CARRIER OFFICIALS

PROBLEM

Carrier officials were given bonuses, salary increases and promotions. Aside from the added expense to the carrier, the innovative and management capabilities of the executive officers were diverted from their prime business responsibility of operating the carrier to the expansion objectives of the holding company to the detriment of the carrier.

RECOMMENDATIONS

That where carrier officials are diverted from their primary responsibilities that Commission approval be required of such arrangements, fully disclosing all aspects of the arrangements such as the category of officials involved, their carrier responsibilities, the types of services which will be performed for the holding company, and the methods of allocating costs between the carrier and holding company.

DETAILS

We believe the management capabilities of key carrier officials were devoted primarily to the needs of the holding company. The following changes in compensation were made:

W. Jerome Strout. Prior to ownership by a holding company, he was Executive Vice-President of the carrier. During ownership by the B&A Corp. (12/1/60 to 10/13/64), he was elected a director of the B&A Corp. and President of the carrier. Coincidental with the merger with Punta (10/13/64), Mr. Strout was paid a bonus of \$7,300.00. All other supervisory employees were given bonuses totaling \$39,000.00. While the amounts do not appear large, this was a one-time bonus payment, substantial in relation to the size of the carrier and its regular policy regarding salaries and wages.

After the merger with Punta, Mr. Strout continued as President and Director of the carrier. Also, he was appointed Vice-President and Director of Punta. His entire salary, however, was paid by the carrier, and this was increased from \$32,000.00 to \$50,000.00 between July, 1964, and July, 1967.

W. Gordon Robertson. Mr. Robertson was principal officer of the carrier prior to ownership by a holding company, serving as President and Director. During the first two years of control by B&A Corp., Mr. Robertson served as President and Director of both carrier and B&A Corp. Obviously, he devoted a considerable portion of his time and attention to the vigorous task of expanding the holding company operations. In 1962 he gave up his position as President of the carrier, but continued to exercise control as Vice-Chairman and later Chairman of the Board of Directors of the carrier, while serving the holding company as President and Director and ultimately as Chairman of the Executive Committee and Chief Executive Officer.

Mr. Robertson's salary was increased significantly from \$36,000.00 to \$100,000.00 between July, 1964, and December, 1968. The carrier paid a portion of Mr. Robertson's salary;

whereas, no other company in the group made any direct contribution to the salaries of any holding company officials.

Mr. Robertson served the carrier as Chairman of the Board of Directors and as Chairman of the Executive Committee until shortly after Punta sold the carrier (10/1/69). As of October 28, 1969, he resigned his position as Chairman, but continued to serve the carrier as a member of the Board of Directors, and as a member of the Executive Committee.

Mr. John E. Hess. Mr. Hess was Vice-President of Finance and General Counsel of the carrier prior to the formation of the B&A Corp. When the first holding company (B&A Corp.) was created, Mr. Hess served both the carrier and the holding company in the same capacity. After the merger with Punta, Mr. Hess served the carrier as Vice President - Finance, and the holding company as Vice-President and Secretary. In 1966, he left the carrier and joined Punta as a full-time employee.

SALE OF THE RAILROAD

PROBLEM

As soon as the carrier's ability to contribute to Punta's profit objectives was impaired, and after eliminating most available working capital assets from the carrier, Punta disposed of its investment in the carrier, including its subsidiaries. Newspaper articles indicated the sale resulted in a substantial loss to Punta; however, the loss was primarily the result of an appraisal write-up of railroad properties which increased its investment.

RECOMMENDATION

To prevent this type of corporate manipulation of carriers wholly for financial interests we recommend that approval

of the Commission be required prior to acquisition of a carrier by a diversified holding company, and that specific benefits of the carrier's participation be demonstrated before approval is granted; and that the Commission reserve the authority to order divestiture proceedings where such actions are not in the public interest.

DETAILS

Effective October 1, 1969, Punta disposed of its investment in the carrier and its subsidiaries. Punta's holdings in carrier stock, representing 98.2% of the capital stock outstanding, were sold in a cash transaction to Amoskeag Corporation, a Boston based investment firm, for \$5 million, or about \$28.00 per share.

The press releases announcing the sale refer to a book loss of about \$13 million. We contend that Punta overstated its ownership of the carrier and in fact, including its transactions that caused carrier assets to be used or transferred, there was a net gain.

In determining the impact on Punta's investment in the carrier, we deducted from Punta's recorded investment in the carrier the amount of cash that flowed from the carrier to Punta through normal dividends, special dividends, corporate charges (management fees), and federal income tax benefits to show that the holding company in fact realized a substantial net gain.

After deducting the benefits to Punta from its investment of \$4,785,993, as shown below, we arrived at an actual gain to Punta of \$5,340,000, as follows:

Investment in 177,259 shares of carrier	
stock at \$27 per share	\$4,785,993
Less: Benefits to Punta:	
Corporate charges	528,000

Special charges	158,794
Dividends	1,311,441
Federal income tax contributions	1,628,412
Investment tax credits	1,500,000
	<u>5,126,647</u>
Net Investment	(340,654)
Proceeds from sale	<u>5,000,000</u>
ACTUAL GAIN	<u>\$5,340,654</u>

Punta acquired ownership of carrier stock from the original individual stockholders through two tax-free stock exchanges not involving any cash consideration. In the first exchange, the carrier's stockholders received two shares of B&A Corp. common stock, a new issue, for each share of carrier stock. In the second exchange, the B&A Corp. stockholders received 1.1 share of Punta common and .4 of a share of Punta \$1.25 Convertible Preference stock for each share of B&A Corp. common. In the latter exchange, Punta acquired the carrier and its subsidiaries plus four other companies owned by B&A Corp.

The cost or basis to be used as Punta's investment in capital stock of the carrier and its subsidiaries, therefore, was difficult to determine. The amount of \$18,830,746.00 recorded on the books of the holding company as its investment in the carrier does not represent cost. (See Appendix VI) Instead, it represents B&A Corp.'s cost plus the net equity in undistributed pre-tax net income from December 1, 1960. It also includes a revaluation write-up exceeding \$10 million. The net equity accounting¹ concept was started by the B&A Corp. and continued by Punta.

¹ Equity accounting permits the controlling company to record all the profits from its subsidiaries in its investment accounts when earned rather than when received as a dividend.

B&A Corp. recorded the investment in carrier stock at \$27.00 per share, which was the reported sale price of the carrier's stock on the New York Stock Exchange on November 25, 1960, the latest sale prior to the effective date (November 20, 1960) of such exchange. The same price per share was used with respect to all carrier's shares subsequently exchanged for holding company stock, i.e., B&A Corp. and Punta. See Schedule of Investment in Carrier attached (Appendix VI) for a further analysis of the investment recorded on the holding company's books.

In determining Punta's cost, the market value of Punta's stock given in exchange was considered inappropriate because of the relationship of the number of shares previously outstanding to the number of shares given in exchange. On the other hand, if we were to use the market value of B&A Corp. stock as of the date of exchange (10/13/64), which was \$28.00 per share, further consideration had to be given to B&A Corp.'s investments in the four other subsidiary companies along with the carrier. Those companies had made nominal contributions of dividend income, and except for Goal Credit Corporation, were profitable ventures. They were not sold with the carrier.

Punta's cost per share was deemed to be the per share value of \$27.00, which was the value of carrier stock at the date of the first exchange in 1960, when B&A Corp. acquired the carrier. The total cost of \$4,785,993 was arrived at by multiplying the number of railroad shares exchanged (177,259) times the value of \$27.00 per share. In determining this cost, we eliminated net equity and the revaluation write-up of \$10 million added by Punta in 1965, from the investment of \$18,830,746 reflected in Punta's balance sheet at 9/30/69.

(d) For tax purposes, the selling price of \$5 million represented a profit over the value of the carrier. The amount of profit is not yet known, but the tax base to Punta is the average of the bases to holders of carrier stock on the date they first exchanged their carrier stock for stock of the holding company (12/1/60), in a tax-free exchange.

The write-up by Punta in 1965 in the amount of \$10,288,629 to a value of \$18,384,808 was based on an appraisal by financial consulting firm of Hayden Stone, Inc., to show the "market value of the investment at September 30, 1965."¹ The contra credit to the holding company's books was to consolidated retained earnings.

POST SALE COMMENTS CONCERNING CARRIER'S ASSOCIATION WITH THE HOLDING COMPANY

The following comments or opinions were voiced by top management officials either in conversation or were included in corporate minutes or in a carrier publication directed to the carrier's employees. The excerpts are included as an expression of opinion and reflection of the views of responsible persons within the organization, two of whom also were principal general officers of the holding company. The intent here is to show that in retrospect carrier officials do not have a high regard for the results of the carrier's association with Punta, and that they look with favor upon the change in ownership.

BENEFITS TO THE RAIROAD

"The best thing that Punta did for us was to sell us to Amoskeag . . ." a quote from a conversation with a principal carrier official, when asked to comment on the benefits the railroad received from the holding company.

¹ Annual report to stockholders by Punta, p. 25.

EMPLOYEE MORALE

"Mr. Strout reported that the morale of supervisory employees had improved since the sale of the Company's stock from Punta to Amoskeag . . ." a quote taken from the minutes of a meeting of the Board of Directors of carrier held on January 23, 1970, after the carrier had been sold by Punta. "Mr. Strout" refers to carrier president W. Jerome Strout, who also was a Vice-President and Director of Punta.

WELFARE OF EMPLOYEES AND AREA SERVED

"A primary consideration in the sale was that Mr. Dumaine was a railroad man who would give due consideration to the welfare of the Company employees and the area served . . ." a quote also taken from the corporate minutes of January 23, 1970, by W. Gordon Robertson, former Chairman of the Board of the Carrier, and former principal executive officer of Punta. "Mr. Dumaine" refers to F. C. Dumaine, Jr., President of Amoskeag Company, a new owner of the railroad.

At the same meeting, Mr. Dumaine is quoted as saying, "... that he had no intention of stripping the railroad or turning its management over to any other company."

APPENDIX I

**ORGANIZATION CHART
CORPORATE STRUCTURE**

This attachment shows the corporate relationship of the carrier and those companies involved with ownership of the carrier.

These are presented as :

- (A) *Carrier* prior to its formation of a holding company.
- (B) After carrier created its internally generated holding company — *Bangor & Aroostook Corporation*.
- (C) *Punta Alegre Sugar Corporation* prior to its takeover of the carrier's holding company (B & A Corp.).
- (D) *Bangor Punta Corporation* at December 31, 1968 prior to its sale of the carrier at September 30, 1969.

A. *Bangor & Aroostook Railroad*

- 1. Van Buren Bridge Co.
- 2. Bangor Investment Co.
 - (a) Machine Accounting, Inc.
 - (b) McKay Rock Products Co.
 - (c) Bangor & Aroostook Transportation Co.
(Inactive)

B. *Bangor & Aroostook Corp.*

- 1. Bangor & Aroostook Railroad
 - (a) Van Buren Bridge Co.
 - (b) Bangor Investment Co.
 - (1) Machine Accounting, Inc.
 - (2) McKay Rock Products, Inc.
 - (3) Bangor & Aroostook Transportation Co.
(Inactive)
- 2. Goal Credit Corp. (May, 1961)

3. Bartlett-Snow-Pacific, Inc. (May, 1962)
4. Henry Luhrs Sea Skiffs, Inc. (May, 1962)
5. Bale Pin Co. (August, 1963)

C. *Punta Alegre Sugar Corp.*

1. Punta Alegre Commodities Corp.
 - (a) C-G-F Topeka Grain Elevator
 - (b) Pacific Metals Co., Ltd. (1962)
 - (c) Crown Fabrics (1963)

D. *Bangor Punta Corporation* (December 31, 1968)

1. Bangor Punta Operations, Inc.

Divisions of B.P.O., Inc.

Bartlett-Snow, Cleveland, Ohio

Designs, engineers, fabricates and erects heat processing and bulk handling equipment for the chemical, process and foundry industries.

FECO, Cleveland, Ohio

Custom-engineered industrial ovens and furnaces, heat processing equipment, metal decorating ovens, sheet metal working machinery.

Young Brothers

Inactive

Tu-Bar

Inactive

The Barker Manufacturing Co., Tampa, Florida

Automatic materials — conveying equipment

Suchar, New York, New York

Buys and sells sugar processing equipment.

Jetstream Systems Company, Hayward, California

Custom-engineered processing and materials handling equipment, using controlled jets of air.

The Kinney Company, Providence, Rhode Island
Emblematic jewelry

The Luhres Company, Marlboro, New Jersey
Inboard wood and fiberglass power boats — wood luxury cruisers — fiberglass luxury cruisers.
Ulrichsen Company, Alura Division

Pameco-Aire, S. San Francisco, California
Wholesale distributor of refrigeration and air-conditioning equipment.

Clawgers Associates, Inc., Cherry Hill, N. J.
Printing

The O'Day Company, Fall River, Mass.
Non-auxiliary and auxiliary fiberglass sailboats.
O'Day (Canada) Limited
Canada Yacht and Boat Centre Ltd.

Jensen Marine, Costa Mesa, Calif.
Auxiliary fiberglass ocean-racing sailboats.

Seagoing Boats, Florence, Alabama
Steel and fiberglass houseboats.

Rent-A-Cruise of America, Florence, Alabama
Franchise: rental of houseboats.

Smith & Wesson, Springfield, Mass.
Top quality hand guns, handcuffs and related equipment.

Lake Erie Chemical Co., Rock Creek, Ohio
Tear gas munitions, riot control equipment.

Dominator Company, Kansas City, Missouri
Traffic control systems.

General Ordinance Equipment Corp., Pittsburgh, Pa.
Non-lethal weapons: Mace, etc.

Stephenson Company, Red Bank, New Jersey
Radar speed measuring devices, resuscitators, alcohol testing equipment, rescue and first aid equipment.

Smith & Wesson Leather Co., Monrovia, Calif.
Leather holsters, "Sam Brown Belts," etc.

Smith & Wesson Pyrotechnics, Inc., Jefferson, Ohio
Rocket flares, distress signals, related pyrotechnic devices, line throwing equipment.

Crown Fabrics, New York, New York
Converters and specialists in synthetic fiber technology. Styling, design and marketing of synthetic/natural fiber-blend fabrics.

Knitbrook Mills, New York, New York
Styles, manufactures and markets bonded knitted fabrics.

Knitbrook of Allentown, Pa.
Manufactures single-knitted fabrics primarily for Knitbrook.

Specialty Dyers, Concord, North Carolina
Piece goods dyers and finishers, primarily for Knitbrook.

Laminac, East Rutherford, N. J.
Bonding and laminating of knitted fabrics for Knitbrook and Crown.

Melena, East Rutherford, N. J.
Double knit fabrics of textured acetate and polyester, using jacquard and textured yarns, primarily for Crown.

Loombrook Mills, New York, New York
Inactive

Waukesha Motor Company, Waukesha, Wisconsin

High speed, industrial type, gasoline, diesel, and natural gas engines for farm tractors, fire trucks, lift trucks; laboratory fuel rating engines and total energy systems.

O. & M. Manufacturing Co., Houston, Texas

Radiators and heat exchangers.

Waukesha Alaska, Inc., Anchorage, Alaska

Factory-operated distributorship.

Waukesha Motor Western Limited, Waukesha, Wisconsin

Western hemisphere trading company.

*Department:***Bangor Punta Management Services Co., New York, N. Y.**

Management services for companies in which Bangor Punta has an equity interest.

*Subsidiaries:***Bangor and Aroostook Railroad Company, Bangor, Maine**

(Sold 9/30/69)

All-freight railroad (wholly within the State of Maine)

Van Buren Bridge Co.

Switching company.

Bangor Investment Co.

Real Estate investments.

McKay Rock Products

Mining of stone, including ballast used by the railroad.

Machine Accounting, Inc.

Computer equipment for use of railroad and others.

Amco Liquidating Corp., Bangor, Mass.

Holding company (owner of 1/3 interest in a limited partnership).

BSP Corporation, San Francisco, Calif. (Sold 1969)

Sewage and waste disposal systems; multiple hearth furnaces, hydro-carbon heaters, thermal disc processors.

Bale Pin Company, Boston, Mass.

Emblematic jewelry; rings, pins and emblems for schools and clubs.

Starcraft, Goshen, Indiana

Aluminum, fiberglass outboard and inboard-outboard boats and sailboats; canoes, prams, campers, travel trailers, motor homes, farm equipment.

Duo Marine, Decatur, Indiana

Fiberglass and aluminum outboard and inboard-outboard runabouts.

Metcalf & Eddy, Inc., Boston, Mass.

International integrated civil and sanitary professional engineering firm, specializing in water supply, sewage treatment and refuse disposal.

Metcalf & Eddy, Ltd.

Metcalf & Eddy International, Inc.

Enesco, Inc., New York, New York

Acquisition services and financial planning for several client companies.

Bangor Punta International Capital Co., New York, N. Y.

International financing service.

Springfield Corp., Springfield, Mass.

Public service project involving the refurbishing of homes in Springfield through use of people considered unemployable.

Producers Cotton Oil Company, Fresno, California

Subsidiary of Bangor Punta Corporation. Commercial agriculture; integrated grower, processor, manufac-

turer and merchandiser. Cotton ginning and vegetable oil processing plants.

Prodeo Warehouse Company

100% owned

Prodeo Finance Company

100% owned

South Lake Farms

100% owned

Delta Cotton Company

50% owned

Santa Rita Ginning Co.

50% owned

Arizona Farming Company

Less than 50% owned

Painted Rock Ranches

Less than 50% owned

Producers Cotton Oil Company, or its wholly owned subsidiaries, also has an interest in numerous other subsidiaries or joint ventures.

HISTORY

Bangor Punta Corporation is a diversified holding company which acquired ownership of the Bangor and Aroostook Railroad in October, 1964, through merger of the Punta Alegre Sugar Corporation and Bangor & Aroostook Corporation. The latter company was formed in 1960 as a holding company for the purpose of acquiring the carrier and diversifying the business activities of that company. Corporate changes are summarized below:

<i>Date</i>	<i>Description</i>								
Prior to 12/1/60	Bangor & Aroostook Railroad and its subsidiaries owned by individual stockholders.								
12/1/60	Carrier and its subsidiaries acquired by Bangor & Aroostook Corp., in a tax-free exchange of stock.								
12/1/60 - 10/13/64	Other Bangor & Aroostook Corp. acquisitions: <table><tr><td>May 1961</td><td>Goal Credit Corp.</td></tr><tr><td>May 1962</td><td>Bartlett-Snow-Pacific, Inc.</td></tr><tr><td>May 1962</td><td>Henry Luhrs Sea Skiffs, Inc.</td></tr><tr><td>Aug. 1963</td><td>Bale Pin Co.</td></tr></table>	May 1961	Goal Credit Corp.	May 1962	Bartlett-Snow-Pacific, Inc.	May 1962	Henry Luhrs Sea Skiffs, Inc.	Aug. 1963	Bale Pin Co.
May 1961	Goal Credit Corp.								
May 1962	Bartlett-Snow-Pacific, Inc.								
May 1962	Henry Luhrs Sea Skiffs, Inc.								
Aug. 1963	Bale Pin Co.								
10/13/64	Bangor Punta Alegre Sugar Corp. created through merger of Bangor Aroostook Corp. and Punta Alegre Sugar Corp. Latter company included the following holdings: <table><tr><td>Punta Alegre Commodities Corp.</td></tr><tr><td>C-G-F Topeka Grain Elevator</td></tr><tr><td>Pacific Metals Co. Ltd.</td></tr><tr><td>Crown Fabrics</td></tr></table>	Punta Alegre Commodities Corp.	C-G-F Topeka Grain Elevator	Pacific Metals Co. Ltd.	Crown Fabrics				
Punta Alegre Commodities Corp.									
C-G-F Topeka Grain Elevator									
Pacific Metals Co. Ltd.									
Crown Fabrics									

10/1/67

Name changed from Bangor Punta Alegre Sugar Corp. to Bangor Punta Corporation. Also, Punta Alegre Commodities Corp. name changed to Bangor Punta Operations, Inc. Ownership of carrier and other acquired companies vested in Operations.

10/1/69

Effective date of sale of carrier and its subsidiaries to Amoskeag Company in a stock transaction.

Bangor and Aroostook Railroad is a relatively small, but important railroad serving the northern counties of the State of Maine. Connections to the south include Maine Central to Boston & Maine and Penn Central. Connections to the west include the Canadian National and Canadian Pacific, or Maine Central to Boston & Maine to Delaware and Hudson, etc.

Historically it has been a well managed and profitable enterprise. In recent years, however, profits have declined sharply, due in part to changes in potato traffic. Diversion of potato traffic to trucks is described as resulting from the "deterioration of railroad service" of the major Eastern trunk lines.¹ Some loss of revenue also resulted from marketing changes, i.e., from fresh to processed product.

The carrier maintains general offices at Bangor, Maine. Railway operating revenue and net income for 1969 were \$13.4 million and \$108 thousand, respectively.

¹ Maine Department of Agriculture (MDA Report 69-01, October, 1969, Marketing Fresh Maine Potatoes: Problems in Transportation, page 4).

Boston Herald 10-3-69

AMOSKEAG CO. TO PURCHASE MAINE RAIL LINE

BANGOR, Me. (AP)—Amoskeag Co. has signed an agreement to purchase control of the Bangor & Aroostook Railroad from Bangor Punta Corp. for \$5 million, the two parties announced yesterday.

In announcing the transaction, the firms said the sale will result in "a non-recurring book loss of approximately \$13 million with no tax benefit to Bangor Punta Corp."

The freight carrier's stock is carried on Bangor Punta's books at approximately \$18 million.

The railroad said Bangor Punta will receive no tax benefit from the loss and part of the \$5 million purchase price will be subject to capital gains tax.

F. C. Dumaine Jr., president of Amoskeag, said he contemplates no changes in railroad operation or management. W. Jerome Strout of Bangor will remain president and chief executive of the railroad.

The 78-year-old railroad serves agricultural and forest interests in northern Maine. Since the 1964 merger of Punta Alegre Sugar Corp. with Bangor & Aroostook Corp. it has been a subsidiary of Bangor Punta.

Bangor Punta is a diversified manufacturing company with holdings in the public security, leisure time, energy and textile fields.

Amoskeag is a Boston-based holding company.

APPENDIX IV

AMOSKEAG COMPANY

Amoskeag Company is a Boston based investment firm, whose president, F. C. Dumaine, Jr., and family have long been associated with the railroad industry. Dumaine formerly was president of the New York, New Haven and Hartford, and the Delaware and Hudson Railroads.

Amoskeag's investments also include 26.15% stock ownership of the *Maine Central Railroad*. This stock was placed in trust with the Irving Trust Co., New York, prior to Amoskeag's purchase of the Bangor and Aroostook Railroad.

Amoskeag's principal investments, listed in Standard and Poor as of April, 1969 under subsidiaries and affiliated companies include the following:

- Champlain National Co.
- Computek, Inc.
- Intercomputer Corp.
- Fanny Farmer Candy, Inc.
- Fieldcrest Mills, Inc.
- Maine Central Railroad
- Springfield Street Railway
- Worcester Bus Co.
- Westville Homes Corp.

A variety of other investments listed include holdings in nationally recognized companies, but none are substantial enough for the companies to be classified as subsidiaries or affiliates.

NICOLAS M. SALGO

Nicolas M. Salgo (Salgo) was the strong personality providing the drive behind the carrier's formation of a holding company and its later involvement with a diversified holding company, with himself emerging as the top official of the company.

Salgo was presented to the Carrier's Board of Directors at a meeting held March 1, 1960, as the person qualified to carry out its diversification program, which was approved by the directors at that same meeting. At March 25, 1960, the carrier entered into a formal employment contract with Salgo which provided that he was:

"to suggest and develop an overall program for diversification of business activities of the Company, to explore specific avenues of diversification, to carry approved projects through to execution, and to perform such other similar duties as may from time to time be required by the Board or by the President."

The agreement provided for employment for a period of not less than 10 years, and for his services he was to receive annual compensation of \$12,000.00. Further, the directors granted Salgo an irrevocable option to purchase up to 20,000 shares of its common stock at \$26.50 per share.

In 1960, almost immediately after the contract was consummated, Bangor & Aroostook Corp. (B & A Corp.) was formed and acquired ownership of the carrier, upon the advice of Salgo. B & A Corp., the newly created holding company, took over Salgo's employment contract. With respect to the stock option plan, the number of shares granted was increased to 40,000 at \$13.25 to conform to the

exchange ratio of two shares of holding company stock for one share of carrier stock.

The first company acquired by the B & A Corp. (after the carrier) was Goal Credit Corp., a commercial loan company in which Salgo and members of his family held about a 30% interest. Acquired in 1961, Goal Credit Corp. subsequently suffered substantial losses on outstanding loans and was sold as of July 31, 1966, at approximately book value.

As Director of Corporate Expansion, Salgo arranged for B & A Corp. to acquire four companies,¹ including Goal Credit Corp. The carrier, however, provided the backbone of the B & A Corp.

In 1964, Salgo arranged for the B & A Corp. to merge with *Punta Alegre Sugar Corp.*, a holding company with an operating company and three other subsidiaries. Salgo was Director of Corporate Expansion for B & A Corp. and Chairman of the Board of Punta at the time of merger.

As a result of Cuban assets having been seized by the Castro regime, Punta had a foreign expropriation loss of about \$20 million, which Punta elected to carry forward on its federal income tax return for a period of ten years, of which approximately \$16.5 million was unused. Consequently, Punta incurred no federal income tax liability until 1968.

Through Punta, Salgo achieved some degree of success in his ventures, making full use of carrier assets and the talent of carrier management. As a result, Bangor Punta Corp. was held out by many advocates of carrier diversification as a shining example of what a holding company, through diversification, could do for a carrier.

¹ See Appendix I for details of corporate structure which show affiliated companies.

The carrier furnished management as well as funds for achieving success in Punta's expansion program; however, our review disclosed that the carrier received no benefits in return. When the carrier became weakened through operating difficulties, Punta failed to render the assistance allegedly offered as the benefits for participation in diversified holding company relationships.

APPENDIX VI

**INVESTMENT IN CAPITAL STOCK
BANGOR & AROOSTOOK RAILROAD
PER BOOKS OF ACCOUNT AND REPORTS
TO STOCKHOLDERS**

Bangor & Aroostook Corporation

Investment in carrier stock:

12/1/60

162,561 shares @ \$27.00 \$4,389,147

Additional — at

various dates 14,019 shares @ \$27.00 378,513

\$4,767,660

Add: Net equity in undistributed pre-tax net
income of carrier and its subsidiaries,
1961-1964

1,939,676

Investment 9/30/64, per 1964 Annual Report to
shareholders

\$6,707,336*Bangor Punta Corp.*

10/13/64 Investment balance brought forward
from B & A Corp. books, per above

\$6,707,336

Add: Investment in additional carrier stock
exchanged for Punta shares—679 shares
@ \$27.00 per share

18,333

Net equity in undistributed pre-tax net
income of carrier and its subsidiaries,
1965-1967

1,496,650

Credit from revaluation of investment by
Hayden Stone, Inc., recorded as a credit
to consolidated retained earnings¹

10,288,629

¹ This is merely a write-up of its investment, and consideration must be given to this \$10 million write-up in any publicly announced losses suffered by Punta in its ownership of the carrier.

Adjustment of investment balance on
reports to shareholders 1964-1965 to re-
flect balance of \$18,384,808 per appraisal
report

319,798

Investment 9/30/68, per 1968 Annual Report to
Shareholders

\$18,830,746

APPENDIX VII

SCHEDULE OF OFFICERS AND DIRECTORS

A. Bangor & Aroostook Railroad — December 31, 1960
At date of acquisition by B & A Corp.

Officers

E. D. Van Loben Sels, Chairman
W. G. Robertson, President
W. J. Strout, Exec. V.P.
Carl R. Smith, V.P.
H. L. Cousins, V.P. Mktng.
John E. Hess, V.P.—Finance—Gen. Counsel
C. C. Morris, Treas.
C. E. Delano, Personnel Director

Directors

Edwin E. Parkhurst
W. J. Strout
Geo. H. Seal
W. G. Robertson
F. L. Putnam
T. E. Houghton
H. E. Umphrey
Arthur J. Pierce
D. D. Daigle
E. D. Van Loben Sels
A. J. April
L. F. Parent
W. B. Snow

B. Bangor & Aroostook Corp. — December 31, 1963

Officers

E. D. Van Loben Sels, Chmn.
W. G. Robertson, Pres.

J. E. Hess, V.P. — Gen. Coun. Clerk
 R. D. Plumley, Treas.
 N. M. Salgo, Dir. of Corp. Exp.
 R. H. Peters, Asst. to Pres.

Directors

E. P. Van Loben Sels
 W. G. Robertson
 H. E. Umphrey
 A. J. April
 G. H. Seal
 W. E. Hill
 F. M. Rodenberger
 H. C. Wood
 W. J. Strout
 R. L. Chambers
 F. Chorin

C. Punta Alegre Sugar Corp. 9/30/63

Prior to merger with B & A Corp.

- (x) N. M. Salgo, Chmn. & Chief Exec. Officer
 R. L. Chambers, Pres.
 T. D. Stephenson, V.P. Sec. & Treas.
 R. J. Gilmartin, Asst. Sec.
 Stephen Galle, Asst. Sec.
 R. S. Burnham, Asst. Sec.

Directors

W. H. Schaum
 W. C. Douglas
 G. S. Jones
 F. H. Kingsbury, Jr.
 J. G. Tremaine
 R. G. Stone
 N. M. Salgo

W. B. McKinney

R. L. Chambers

(x) W. G. Robertson

(x) Neither Salgo nor Robertson were listed as an officer or director as of 9/30/60. Salgo was employed by carrier as of 3/25/60.

D. *Bangor Punta Corp.* 9/30/69

Date carrier was sold

Officers

N. M. Salgo, Chairman of the Board

W. G. Roberston, Chief Exec. Officer

Chmn. of Executive Comm.

D. W. Wallace, Pres. & Chief Operations Officer

Stephen Galle, Senior V.P.

J. E. Flick, Senior V.P. — Gen. Counsel — Sec.

T. D. Stephenson, Adm. V.P. & Treas.

C. E. Delano, V.P. — Personnel

D. C. Morrill, V.P. — Corp. Relations

M. F. Wray, V.P. — Acquisitions — Mergers

Harold Ehrenstrom, V.P.

D. C. Phillips, V.P.

J. L. Oberg, V.P.

Directors

William E. Hill

W. C. Douglas

G. S. Jones

F. H. Kingsbury, Jr.

J. G. Tremaine

R. G. Stone

N. M. Salgo

W. B. McKinney

W. G. Robertson

C. M. Hutchins
H. S. Baker
S. K. Lowry
George H. Seal
H. C. Wood
J. E. Flick
R. A. Page
C. E. Nelson
D. W. Wallace

E. *Amoskeag Co.* 9/30/69

Date acquired carrier

Officers

W. B. Snow, Chmn. of Board
F. C. Dumaine, Jr., Pres.
D. B. Dumaine, V.P.
H. T. Wiggin, Treas.
T. H. Casey, Controller
F. P. Melzar, Sec.

Directors

F. J. Sulloway
A. B. Hunt, Jr.
F. C. Dumaine, Jr.
A. B. Hunt
W. B. Snow
Ralph Lowell
J. I. Ahern
H. E. Melzar
H. M. Cole

F. *Bangor & Aroostook Railroad* 12/31/69

After sale to Amoskeag

Officers

W. J. Strout, President

W. M. Houston, V.P. — Gen. Counsel

Donald B. Annis, Treas.

Owen J. Gould, Controller

Directors

William E. Hill

Joseph R. Lapointe

George H. Seal

Richard K. Warren

H. C. Wood

T. E. Houghton, Jr.

J. R. McPike

Wendell L. Phillips

W. G. Robertson

D. D. Daigle

Dudley B. Dumaine — 10/28/69

F. C. Dumaine, Jr. — 10/28/69

Roger B. Prescott, Jr. — 10/28/69

Fred L. Putnam

Jack Roth

W. J. Strout

APPENDIX VIII

SCHEDULE OF CASH BENEFITS TO HOLDING COMPANY

Description	Received by B&A Corp.	Received by Punta
Corporate Charges or Management Fees	\$ 282,479	\$ 528,000
Special Corporate Charge		158,794 ¹
Gain on Marketable Securities	782,362	
Dividends:		
Regular		424,874
Special	459,108	886,567 ²
Federal Income Tax Benefits:		
From Operating Losses		1,628,412 ³
From Investment Tax Credits		1,566,787
Totals	<u>\$1,523,949</u>	<u>\$5,193,434</u>

¹ Recommended Recovery

Tax Deficiency

Attributable to carrier and its subsidiaries	\$ 46,421	
Attributable to others	112,373	\$158,794

Chargeable to Carrier

Carrier portion of tax deficiency	46,421	
Interest assessed	48,838	95,259

Refund due carrier

\$ 63,535² To liquidate debt.³ 48% of net operating losses contributed to Punta's consolidated tax return.

BRIEF FOR RESPONDENTS

APPENDIX C

**SUMMARY OF ARGUMENTS
MADE BY THE RAILROAD
IN THE COURT OF APPEALS
BUT NOT PASSED UPON BELOW**

**1. Equitable Defenses May Not Bar Claims Based on the
Federal Antitrust Laws**

Federal law controls what defenses are available against claims based on federal law. *Dice v. Akron, C. & Y. R.R.*, 342 U.S. 359, 361 (1952), *Isidor Weinstein Investment Co. v. Hearst Corporation*, 303 F.Supp. 646, 649 (N.D.Calif. 1969) Common law barriers should not be applied. *Perma Life Mufflers v. International Parts*, 392 U.S. 134, 138-9 (1968) The unclean hands defense has been repeatedly rejected, because of the public policy of deterring antitrust violations. *Magna Pictures Corp. v. Paramount Pictures Corp.*, 265 F.Supp. 144, 149 (C.D.Calif. 1967), *Waldron v. British Petroleum Co.*, 231 F.Supp. 72, 92 (S.D.N.Y. 1964), *Trebuhs Realty Co. v. News Syndicate Co.*, 107 F.Supp. 595, 599 (S.D.N.Y. 1952) This public policy of deterrence indicates that an innocent party plaintiff should not be barred by a defense of unjust enrichment, particularly where the innocent party plaintiff is a railroad bringing suit under §10 of the Clayton Act against a former controlling stockholder.

**2. Equitable Defenses May Not Bar Claims Based on the
Federal Securities Laws**

Federal law governs the extent of the remedies available under the federal securities laws. *J. I. Case Company v.*

Borak, 377 U.S. 426, 433 (1964), *Clement A. Evans & Co. v. McAlpine*, 434 F.2d 100 (CA5 1970), cert. denied 402 U.S. 988, rehearing denied 404 U.S. 874, *Kohler v. Kohler Co.*, 319 F.2d 634, 642 (CA7 1963) The "unclean hands" defense is not available in securities actions because of the public policy of deterring violations. *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F.Supp. 50 (S.D.N.Y. 1971), *Pearlstein v. Scudder & German*, 429 F.2d 1136, 1141 (CA2 1970), cert. denied 401 U.S. 1013, *Hooper v. Mountain States Securities Corporation*, 282 F.2d 195 (CA5 1960), cert. denied 365 U.S. 814. This public policy of deterrence indicates that an innocent party plaintiff should not be barred by a defense of unjust enrichment. *Janigan v. Taylor*, 344 F.2d 781, 786 CA1 1965), cert. denied 382 U.S. 879, cited with approval in *Affiliated Ute Citizens v. U.S.*, 406 U.S. 128, 155 (1972).

Page 6

In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-718

**BANGOR PUNTA OPERATIONS, INC. AND BANGOR PUNTA
CORPORATION, PETITIONERS**

v.

**BANGOR & AROOSTOOK RAILROAD COMPANY AND BANGOR
INVESTMENT COMPANY, RESPONDENTS**

**ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIRST CIRCUIT**

**BRIEF OF THE INTERSTATE COMMERCE COMMISSION
AS AMICUS CURIAE**

OPINIONS BELOW

The opinion of the District Court is reported at 353 F. Supp. 724 (D. Me. 1972) (App. 30-41). The opinion of the Court of Appeals for the First Circuit is reported at 482 F. 2d 865 (App. 54-67).

JURISDICTION

The petition for a writ of certiorari was granted on January 7, 1974. The judgment of the Court of Appeals was entered on August 3, 1973. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

(1)

STATUTES INVOLVED

The applicable sections of the Clayton Act, Securities Exchange Act of 1934, and the Interstate Commerce Act are set forth in Petitioner's Appendix (App. A-1-A-9).

QUESTION PRESENTED

Whether a railroad has standing to bring an action in its own name against a former holding company which has the effect of vindicating the public interest.

STATEMENT

The Bangor and Aroostook Railroad Company (BAR) and its wholly owned subsidiary, Bangor Investment Company (BIC), brought suit against the Bangor Punta Corporation (Bangor Punta) and its wholly owned subsidiary, Bangor Punta Operations (BPO) in the District Court for the District of Maine. Bangor Punta, a diversified holding company, through its subsidiary BPO, formerly held a majority interest in, and controlled BAR. At the time BAR brought the action against its former holding company, Bangor Punta, BAR was substantially owned and controlled by Amoskeag Company, another investment company.

In 1971, the Bureau of Accounts of the Interstate Commerce Commission, after a study of the intercorporate financial transactions between the BAR and its former holding company, forwarded a report to the Commission, *Report of Diversified Holding Company Relationships And Transactions of Bangor Punta Corporation*. After analyzing certain intercorporate

transactions, the Bureau recommended that steps be taken to have the former holding company make restitution to the railroad for misappropriation of the carrier's assets.

In June of 1971, the Chairman of the Surface Transportation Subcommittee, Senate Committee on Commerce, requested that the Commission furnish the Committee with all the information gathered by the Commission on conglomerate mergers in the rail industry. The Bangor Punta study, along with other information and studies, was forwarded to the Committee.

Sometime thereafter the Board of Directors of BAR obtained the study, and after deliberation, authorized the chief executive officer of BAR to institute action against Bangor Punta and BPO in the name of BAR. The complaint sought damages for misappropriation and waste of corporate assets, and was brought both under the common law of Maine, and under various Federal statutes (see App. 2a).

The district court granted defendant Bangor Punta's motion for summary judgment dismissing the complaint (App. 1a-12a). The district court held that the present owner of the railroad, the Amoskeag Company, is the real party in interest and would be the real beneficiary of the proceeds of the suit. The court concluded that since Amoskeag was a subsequent purchaser, it was "barred from maintaining a derivative suit on behalf of BAR for the wrongs alleged to have occurred before Amoskeag purchased its BAR shares" (App. 4a).

On appeal, the First Circuit sent the matter back to the district court to be determined on its merits. In sending the matter back, the court held that the public's interest inherent in viable railroads is sufficient to provide standing for the Bangor & Aroostook—apart from Amoskeag's interest—to maintain the action. As the First Circuit stated (App. 19a-20a):

The public's interest, unlike the private interest of stockholder or creditor, is not easily defined or quantified, yet it is real and cannot, we think, be overlooked in determining whether the corporation, suing in its own right, should be estopped by equitable defenses pertaining only to its controlling stockholder. Here we think the public's interest in the financial health of BAR provides a separate interest, quite apart from Amoskeag's, which is served by the corporate cause of action. Thus, regardless of the latter's motivations or potential receipt of undeserved benefits, BAR should be permitted, and indeed has a duty, to recover for itself any assets which were divested from it in violation of state or federal law. (Footnote omitted.)

Thus, in finding the public's "real, if inchoate interest" (App. 24a) sufficient to provide BAR standing to maintain the suit in its own name, the circuit court remanded the matter to be determined on its merits.

In their Brief to this Court, the petitioners argue *inter alia* that the circuit court erred in recognizing the railroad's standing to maintain an action which would redound to the public interest because of some

alleged ability of the Interstate Commerce Commission to protect the public interest in this type of a situation (Br. p. 15).

ARGUMENT

I

THE INTERSTATE COMMERCE COMMISSION HAS NO JURISDICTION OVER ONE-RAILROAD HOLDING COMPANIES

Section 5(2) of the Interstate Commerce Act, 49 U.S.C. § 5(2) (a copy of which is attached) is the section which vests the Commission with authority to approve mergers or acquisitions of rail carriers. Section 5(2)(a)(i) makes Commission authorization necessary for "a person which is not a carrier to acquire control of two or more carriers though ownership of their stock or otherwise." Commission authority is also necessary when a single-railroad holding company attempts to acquire control of a second railroad.

Section 5(3) of the Act, 49 U.S.C. § 5(3) (also attached as an appendix hereto) authorizes the Commission to designate a non-carrier as a carrier and subject it to certain requirements. Section 5(3) provides in part that "[w]henever a person which is not a carrier is authorized, by an order entered under paragraph (2), to acquire control of any carrier or of two or more carriers, such person thereafter shall, to the extent provided by the Commission in such order, be considered as a carrier * * *"

Thus, in cases such as one here where a railroad generates its own holding company, that holding com-

pany escapes the Commission's regulation.¹ Furthermore, even assuming the Commission had jurisdiction over Bangor Punta as a designated carrier, it is still questionable whether the Commission could have regulated the intercorporate transfer of assets complained of by BAR. Under section 5(3), when a person is designated a carrier it is subjected to sections 20(1)-(10) and 20a of the Act, 49 U.S.C. §§ 20(1)-(10), 20a. Section 20 deals with the records, reports, and accounts to be kept by carriers. Section 20a subjects to the Commission's jurisdiction the carriers' issuance of securities. But "securities," as defined by section 20a(2), does not embrace intercorporate asset transfers or advances to or from affiliates.

That question aside, however, both the Commission and its two overseeing committees of Congress recognize the present gap in the Commission's regulatory authority. See hearings on *Failing Railroads*, before the Senate Commerce Committee, Serial No. 91-90, p. 166 et seq. (1970), and hearings on *Emergency Rail Services Legislation* before the Subcommittee on Transportation and Aeronautics, House Committee on Interstate and Foreign Commerce, Serial No. 91-86, pp. 199 et seq. (1970). Presently pending before

¹ In addition to the clear case, as here, of the lack of jurisdiction over a single-railroad holding company, the Commission has consistently held that, under the statute, it lacks jurisdiction over holding companies which control a single integrated railroad system, or "single established carrier system." See e.g. *Louisville & J.B. & R. Co. Merger*, 295 I.C.C. 11 (1955); *Kansas City Southern Industries, Inc.—Control—Kansas City Southern Ry. Co.*, 317 I.C.C. 1 (1962).

both Houses are Bills to extend the Commission's regulation to conglomerate holding companies, S. 2460, introduced on September 20, 1973; H.R. 11092, introduced October 24, 1973.

It is clear that, contrary to petitioners' arguments, the Commission was not empowered to protect the public interest in the intercorporate dealings which are the subject of the instant controversy. This lack of regulatory authority, in part, necessitates the position taken by the First Circuit.

II

THE COURT ACTED PROPERLY IN HOLDING THAT THE RAILROAD HAD STANDING TO BRING THIS ACTION

The petitioners argue that the First Circuit disregarded *Sierra Club v. Morton*, 405 U.S. 727 (1972). This is not an action brought by a party claiming representative status to vindicate a public interest. Nor is it a derivative suit brought by Amoskeag. Rather, the suit was commenced by the Bangor & Aroostook Railroad in its own name.²

The continued financial health of railroads, as necessary public utilities, is undeniably a matter of major public concern. Here, the interests of the public

² The doctrine of contemporaneous ownership under Rule 23.1 of the Federal Rules of Civil Procedure does not apply to a suit brought by a corporation itself to enforce its own rights. *Central Ry. Signal Co. v. Longden*, 194 F. 2d 310 (7th Cir. 1952); *Mauck v. Mading-Dugan Drug Company*, 361 F. Supp. 1314 (N.D. Ill. 1973). Here, after studying the Bureau of Accounts' report, the new directors of the Bangor & Aroostook authorized the chief executive officer of the railroad to institute suit in the carrier's own name.

and the railroad plaintiff largely overlap—and the “inchoate but real” public interest in viable railroads brings the facts of the present case well beyond the usual limits of the contemporary ownership rule.

The railroad brought the action in its own name, and if successful the proceeds will redound to the public interest.³ Given these facts, it is respectfully submitted that the First Circuit acted properly in remanding the cause to the district court for a determination on its merits.

Respectfully submitted.

FRITZ R. KAHN,

General Counsel,

BETTY JO CHRISTIAN,

Associate General Counsel,

CHARLES H. WHITE, Jr.,

Attorney,

Interstate Commerce Commission.

³ As the First Circuit pointed out (App. 25a), if the railroad prevails on the merits, the district court can call on the aid of state and federal agencies in insuring that the proceeds will not be unreasonably diverted to the private enrichment of the stockholders.

APPENDIX

Section 5(2) of the Interstate Commerce Act, 49 U.S.C. § 5(2) provides in pertinent part:

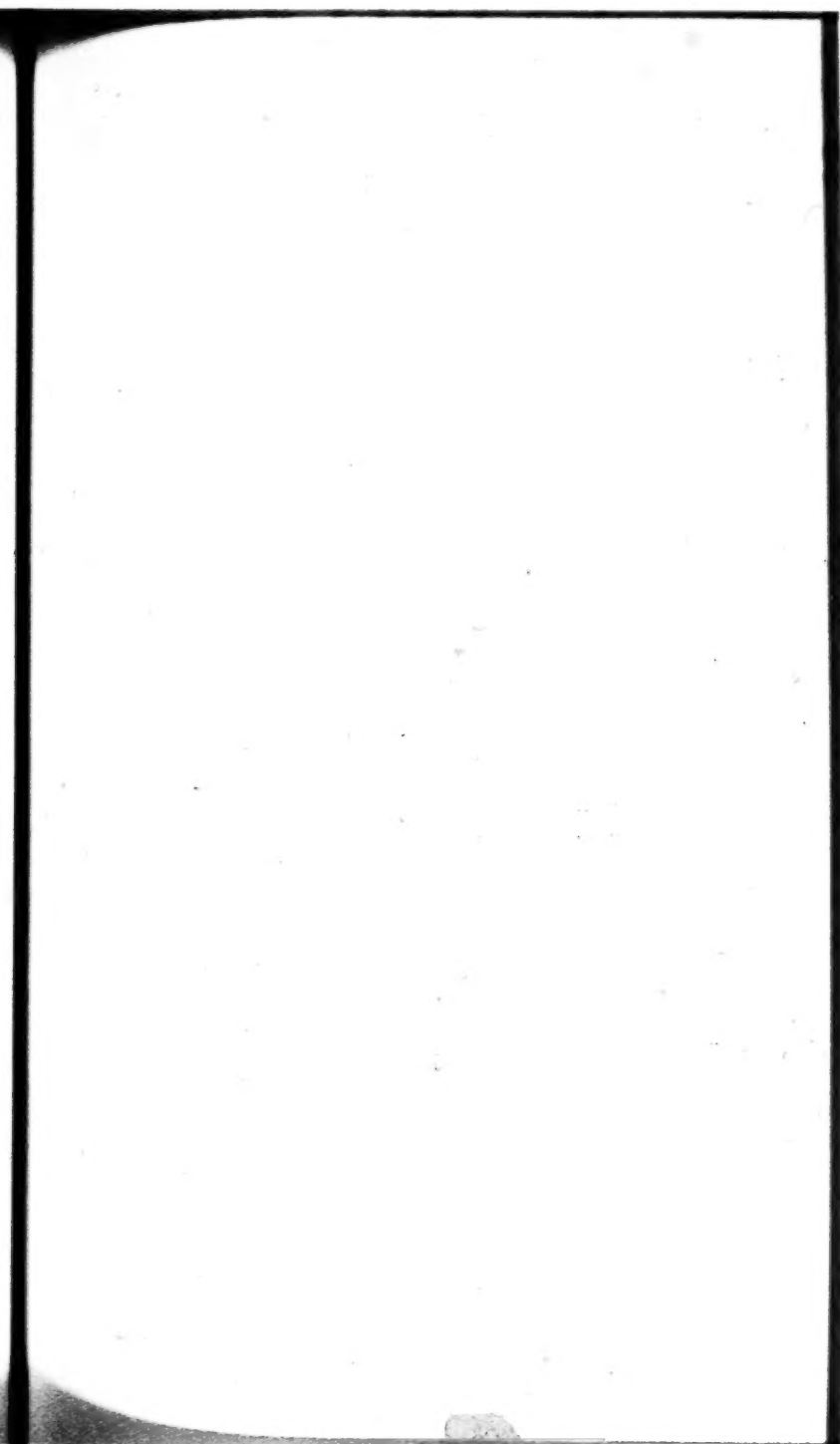
(2)(a) It shall be lawful, with the approval and authorization of the Commission, as provided in subdivision (b)—

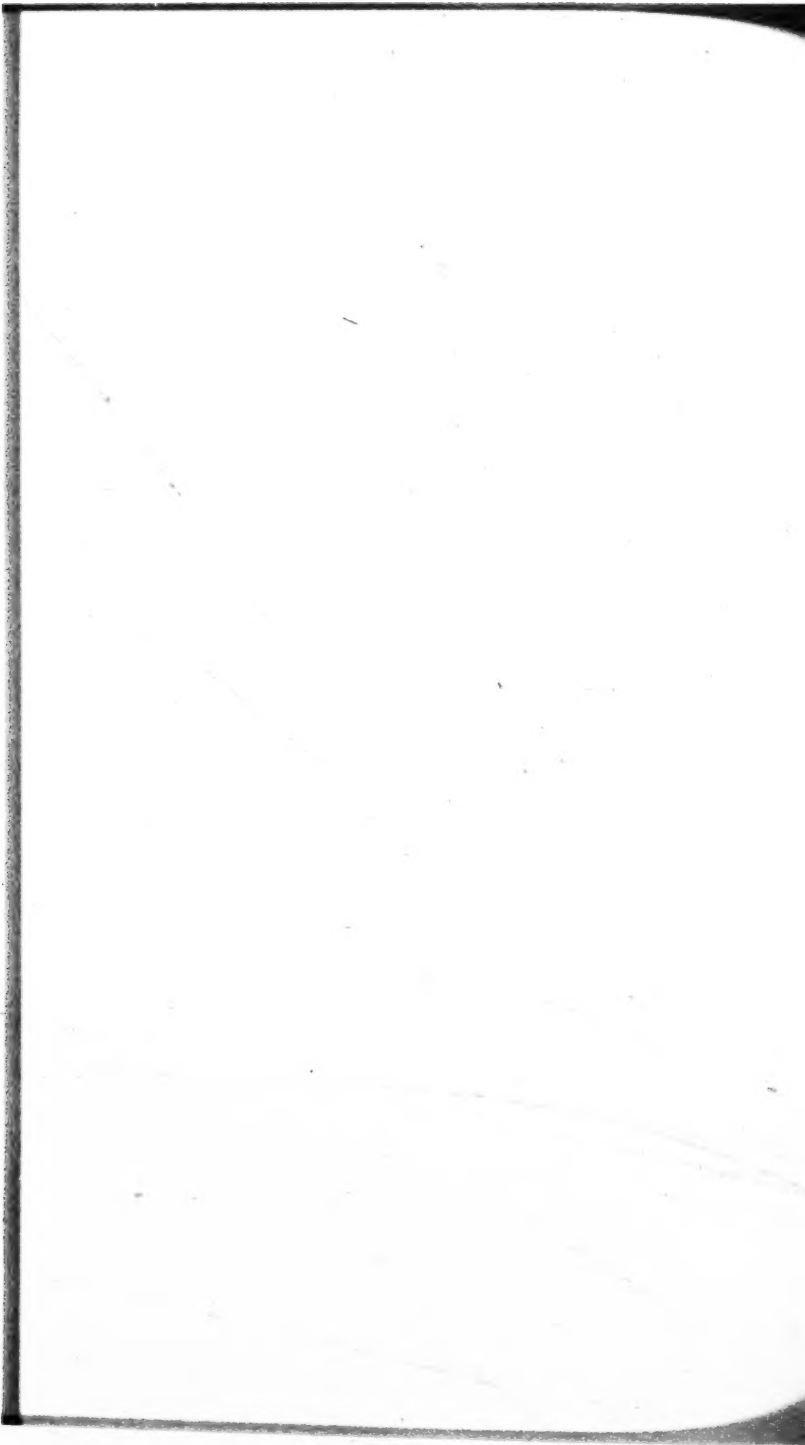
(i) for two or more carriers to consolidate or merge their properties or franchises, or any part thereof, into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership; or for any carrier, or two or more carriers jointly, to purchase, lease or contract to operate the properties, or any part thereof, of another; or for any carrier, or two or more carriers jointly, to acquire control of another through ownership of its stock or otherwise; or for a person which is not a carrier to acquire control of two or more carriers through ownership of their stock or otherwise; or for a person which is not a carrier and which has control of one or more carriers to acquire control of another carrier through ownership of its stock or otherwise; or

Section 5(3) of the Act, 49 U.S.C. § 5(3), provides in pertinent part:

(3) Whenever a person which is not a carrier is authorized, by an order entered under paragraph (2), to acquire control of any carrier or of two or more carriers, such person thereafter shall, to the extent provided by the Commission in such order, be considered as a carrier subject to such of the following provisions as are applicable to any carrier involved in such acquisition of control: Section 20 (1) to (10), inclu-

sive, of this part, sections 204(a) (1) and (2) and 220 of Part II, and section 313 of part III, (which relate to reports, accounts, and so forth, of carriers), and section 20a (2) to (11), inclusive, of this part, and section 214 of part II, (which relate to issues of securities and assumptions of liability of carriers), including in each case the penalties applicable in the case of violations of such provisions.





FILE COPY

FILED

APR 11 1974

MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 718

BANGOR PUNTA OPERATIONS, INC. and BANGOR
PUNTA CORPORATION,

Petitioners,

v.

BANGOR & AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITIONERS' REPLY BRIEF

JAMES V. RYAN

ROGER L. WALDMAN

ALLAN J. GRAF

One Rockefeller Plaza

New York, New York 10020.

Counsel for Petitioners

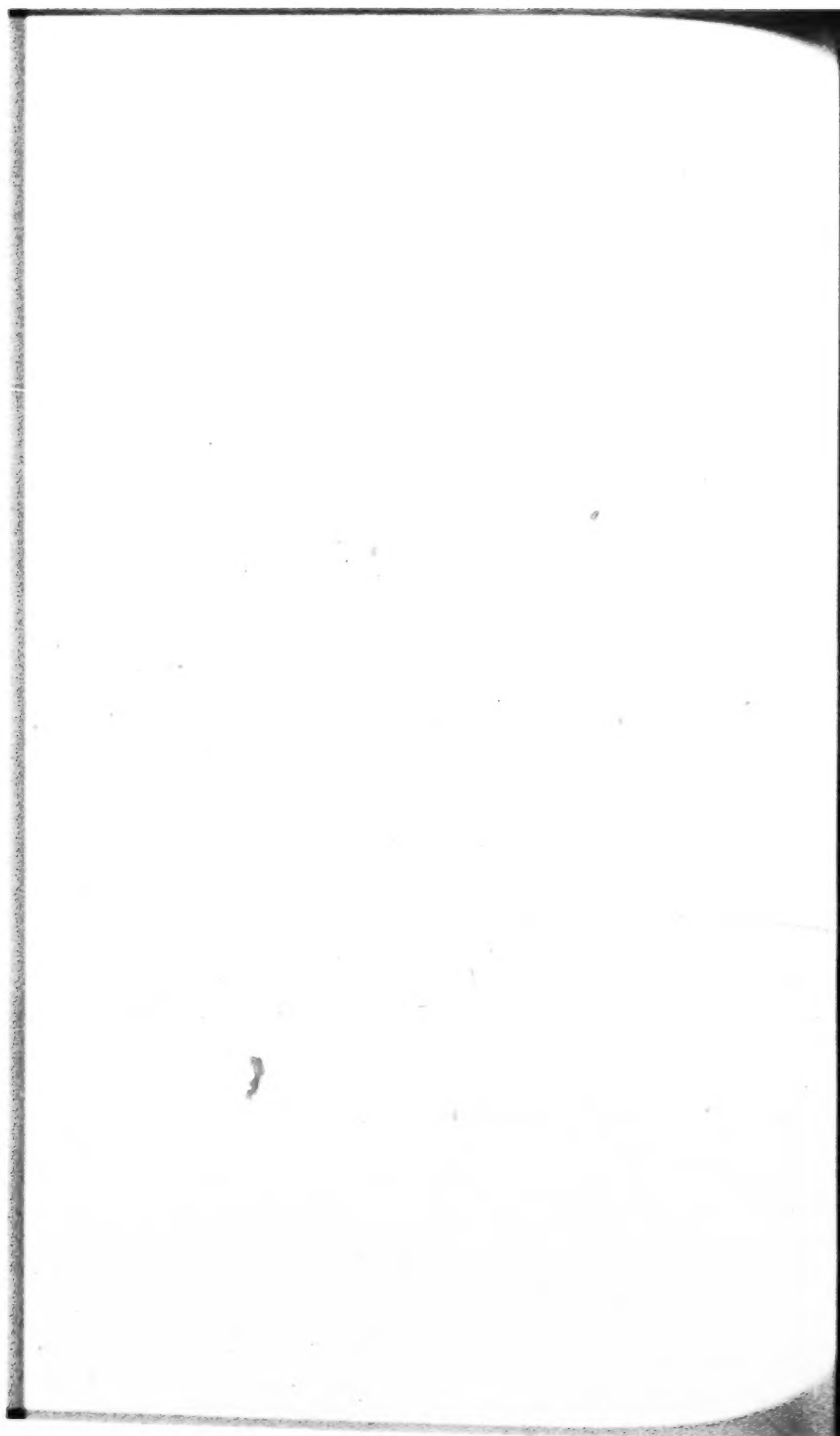
WEBSTER SHEFFIELD FLEISCHMANN

HITCHCOCK & BROOKFIELD

BERNSTEIN SHUB SAWYER & NELSON,

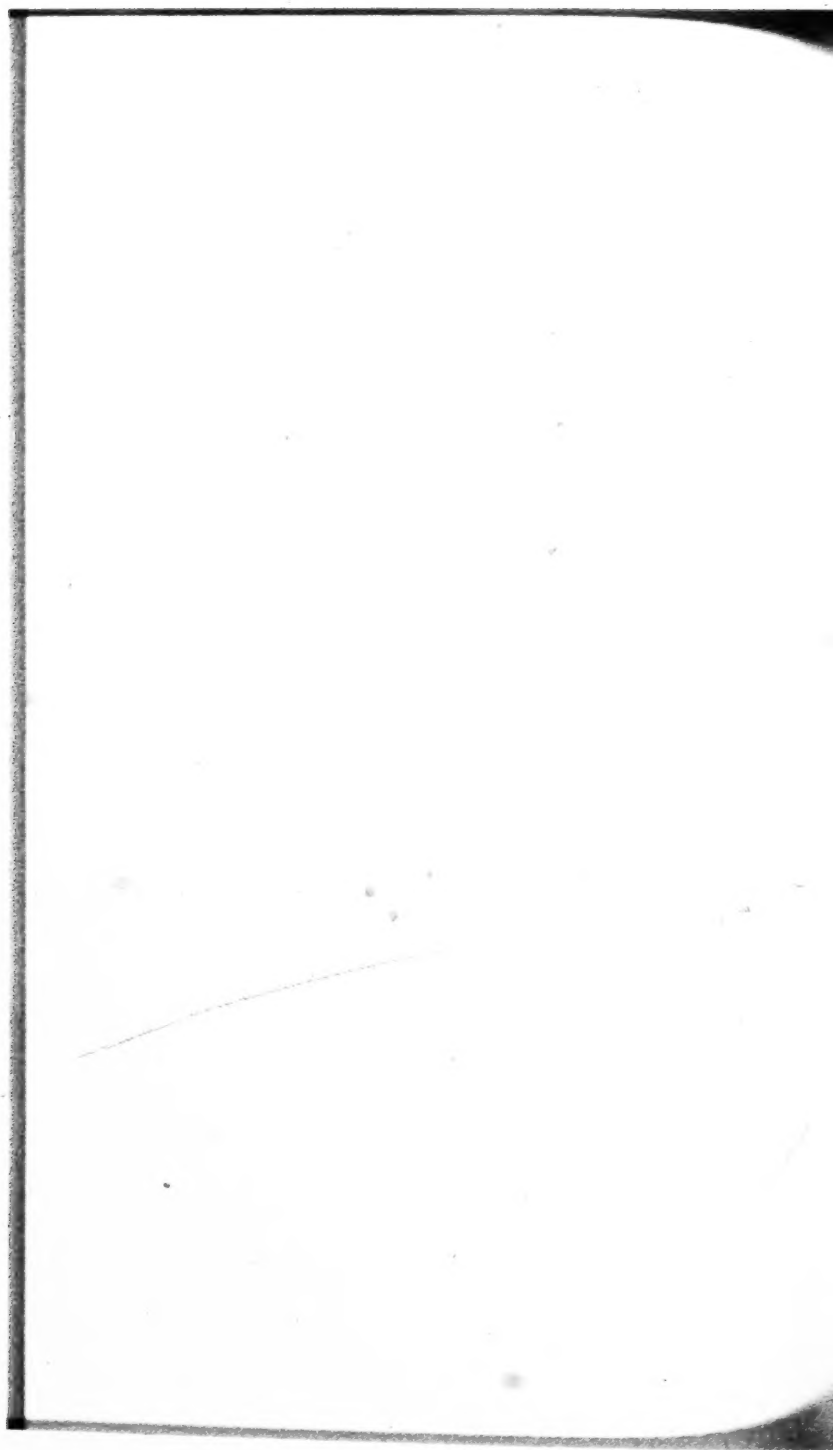
Of Counsel.

April 11, 1974.



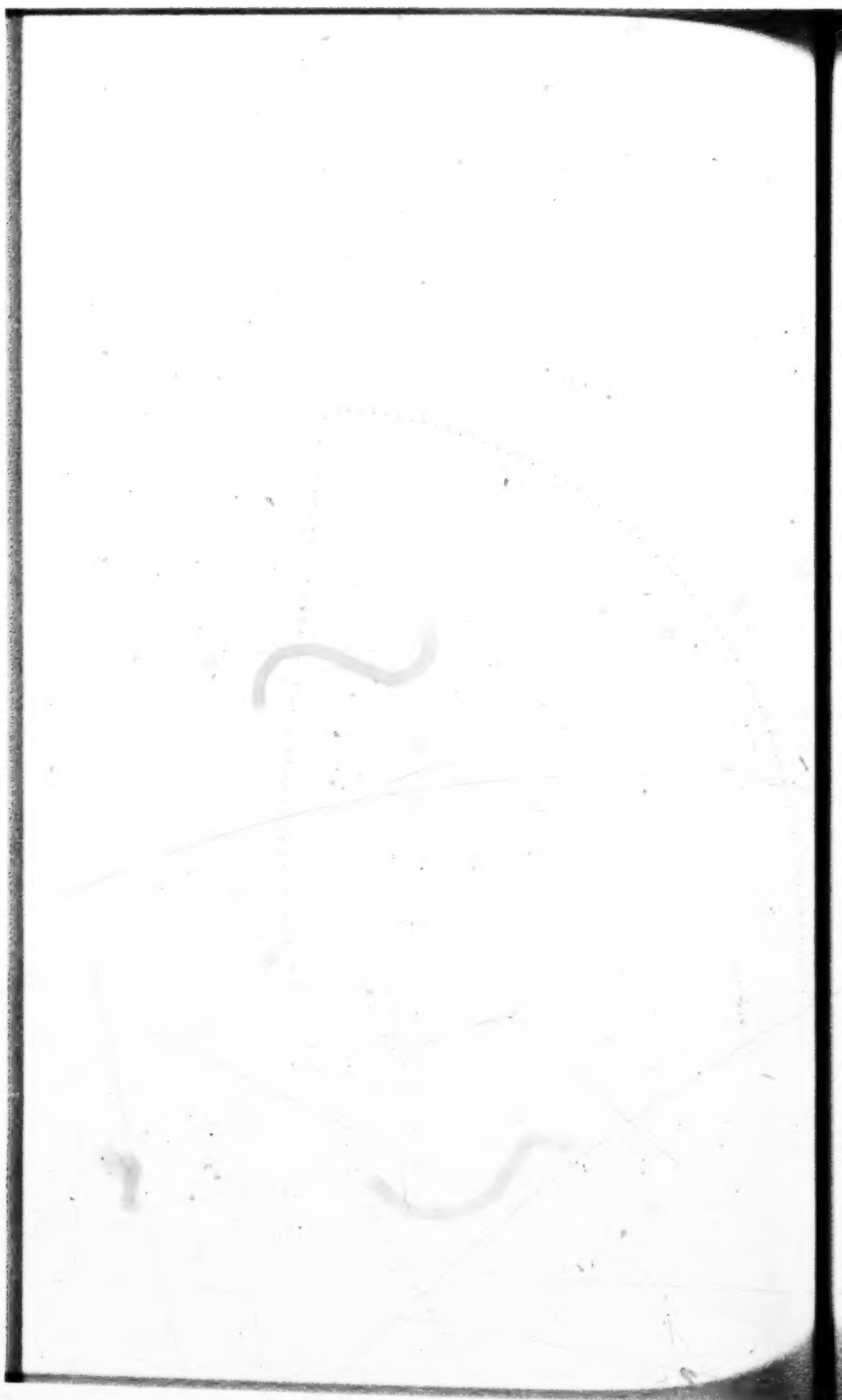
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IN THE
Supreme Court of the United States

OCTOBER TERM, 1973

No. 718

BANGOR PUNTA OPERATIONS, INC. and BANGOR
PUNTA CORPORATION,

Petitioners,

v.

BANGOR & AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITIONERS' REPLY BRIEF

This brief is submitted by Petitioners Bangor Punta Operations, Inc. and Bangor Punta Corporation in reply to the brief of the Respondents Bangor & Aroostook Railroad Company and Bangor Investment Company.

I. Respondents Have Abandoned the First Circuit's Rationale and Now Premise Their Right to Sue on an Asserted Lack of Judicial Power to Look Behind the Corporate Form.

Candidly conceding that Amoskeag, the 99% owner of respondents, would not have standing to bring the action (Resp. Br. 28-29), respondents rely principally on a contention that a federal court may not look behind the corporate form to the real parties in interest and beneficiaries

of a corporate recovery. Respondents argue that the fact that the corporation is the nominal plaintiff is decisive, in that the law of Maine and decisions of this Court foreclose further inquiry (Resp. Br. 10-13). Respondents also contend that the "injury in fact" test of constitutional standing is subject to the same limitation (Resp. Br. 23-25).

No extended discussion is necessary to deal with the foregoing contention. Both this Court and the Supreme Judicial Court of Maine have consistently upheld their power to look behind the corporate form to the shareholders. See *Anderson v. Abbott*, 321 U.S. 349 (1944); *NLRB v. Deena Artware, Inc.*, 361 U.S. 398 (1960); *Bonnar-Vawter, Inc. v. Johnson*, 173 A.2d 141, 145 (Me. 1962), and as pointed out in our main brief (p. 20), this Court has been particularly zealous to do so in cases involving access to the federal courts. That the rule is no different for railroads is demonstrated by this Court's decision in *Chicago, Milwaukee & St. Paul Ry. Co. v. Minneapolis Civic Assn.*, 247 U.S. 490 (1918), where in piercing the corporate veil of a railroad, the Court stated the applicable principal:

"... The courts will not permit themselves to be blinded or deceived by mere forms or law but, regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require." (247 U.S. at 501)

The more significant aspect of respondents' contention is that it abandons the rationale that was the basis of the First Circuit's decision. As did the District Court, the First Circuit rejected respondents' contention that it could not look through the corporate form holding—contrary to the rule laid down in *Sierra Club v. Morton*, 405 U.S. 727 (1972)—that respondents had standing to sue because they were suing to vindicate a public interest. Respondents now concede the constitutional barrier of *Sierra* and revert to

a contention, rejected by both courts below, which exalts form over substance.

That the lower courts were correct in rejecting the blinders urged upon them is evident. It is precisely to prevent unjust enrichment and like inequities that courts have traditionally pierced the corporate veil. Moreover, to contend, as respondents do, that alleged acts which concededly caused no injury to stockholders, creditors or any other persons having an interest in the corporation nonetheless cause the injury-in-fact necessary to meet the constitutional test of standing is absurd.

II. The Public's Interest in Rail Service Is Not Involved.

Respondents' second contention (Resp. Br. 13-17) is that the public's interest in railroads justifies the present action. While respondents do not specify precisely what public interest allegedly is involved, their citation of various decisions dealing with the public's interest in continued service during railroad reorganizations (Resp. Br. 16-17) and the "present rail crisis in the Northeast and Midwest" (Resp. Br. 16) implies that BAR's financial capacity to provide continued rail service has been impaired by the acts alleged and is involved in the instant action.

No such impairment was alleged in the complaint and nothing could be further from the mark. Far from being in financial straits, BAR is earning profits, paying dividends, and retiring debt. In a letter to shareholders dated October 29, 1973, management declared a \$1.00 dividend, stating "the financial health of the company is excellent," and reporting that during the year the company had retired \$3,264,100 of debt and made capital improvements of \$483,000. The foregoing dividend was the second declared in 1973, management having declared a \$1.00 dividend in June in a letter which reported earnings of \$1,508,368 and \$1,502,354 for 1971 and 1972, respectively. The June letter stated that the dividend had been declared

because of the company's "satisfactory profits and overall financial condition", and that management was "proud of being the only Northeast Carrier with the ability to pay a dividend".*

BAR's solvency and declaration of dividends make untenable respondents' further contention that a decree can be framed which will ensure that a corporate recovery inures to the public benefit. The First Circuit recognized that courts lack power to prevent any but illegal distributions (App. 66). It is evident from BAR's recent payment of dividends that distribution of a corporate recovery to shareholders as a dividend would violate no law.

Moreover, assuming *arguendo* that a court did have the power to issue a decree regulating the use of proceeds, or even that respondents entered into a stipulation with regard thereto (Resp. Br. 30), there would still be no assurance of public benefit. Cash is fungible. A decree or stipulation requiring that any recovery be invested in plant or equipment would only free other corporate funds for dividends which otherwise would be required for such purposes.

The fact is that the only way a benefit to the public could be assured would be for the court to maintain for the indefinite future the kind of supervision of BAR exercised over corporations in receivership. It is submitted that the courts should not assume such a role with regard to a solvent corporation.

The various cases cited by respondents (Resp. Br. 13-18) have no relevance to the instant case. Colorful dicta aside, the cases hold nothing more dramatic than that railroads are subject to regulation,* that they owe certain specific

* BAR's letters to shareholders dated June 28, 1973 and October 29, 1973 are set out in Appendix A to this brief.

** *Railroad Commissioners v. Portland and O.C. R.R.* (Resp. Br. 16).

duties to the public in laying track,* that when in receivership or reorganization the public interest in continued service is an interest to be considered by the receiver or trustee,** and that former section 15(a) of the Interstate Commerce Act, *which section has been repealed*, was constitutional***. None of these propositions is involved in this action.

III. No Present Congressional Policy Towards Railroads Is Involved. If an Additional Remedy Is to Be Created, It Should Be Done by Congress.

Both respondents and the Interstate Commerce Commission concede that notwithstanding the consistent Congressional attention given to railroads over the past fifty years and the pervasive statutory scheme enacted to protect what Congress deemed to be the public interest in railroads, no part of that legislative and regulatory scheme is involved in the present action. Respondents assert that the "policy" established by the Transportation Acts of 1920 and 1940 has been violated, but cite no provision (Resp. Br. 18). The Commission admits that the intercorporate dealings at issue herein fall within what it terms a "present gap" in the statutory scheme, which it is seeking to remedy by two bills presently pending before both Houses of Congress (Amicus Br. pp. 6-7).

The "gap" in the statute coupled with the pendency of bills before Congress militates strongly against the judicial creation of remedies effected by the First Circuit's decision. As pointed out in our main brief (pp. 15-16), federal courts have consistently deferred to Congress' regulatory scheme and have refused to judicially create remedies which Congress has not provided. Thus even in the

* *Woodstock Iron Company v. Richmond and D. Extension Co.* (Resp. Br. 14).

** *Barton v. Barbour; Union Trust Co. of New York v. Illinois Midland Ry Co.; New Haven Inclusion Cases* (Br. 13, 14, 15).

*** *Dayton-Goose Creek R.R. Co. v. U.S.* (Resp. Br. 18).

absence of pending legislation, the First Circuit's creation of a new remedy would be improper. Here, where Congress is considering legislation and has not yet acted, although the matter was first called to its attention four years ago (*Amicus Br.* p. 6), the case against judicial intervention is even stronger.

The body of law regulating and governing railroads is intricate and detailed, involving delicate adjustments of various competing interests. As demonstrated by the frequent amendment of the Interstate Commerce Act and most recently by the passage of the "Amtrak Act", 45 U.S.C. § 501 *et. seq.*, Congress has shown willingness to amend existing statutes and enact new legislation where it deems the public interest requires it. If, as the Commission suggests, a gap in Congress' statutory scheme exists, it is for Congress and Congress alone to so determine and create a remedy.*

IV. Reversal Of The First Circuit's Decision Will Abridge No Substantive Right Recognized by Maine Law.

Respondents' final contention (*Resp. Br.*, Point III B) is that this Court may not reverse the First Circuit's decision because dismissal of the action assertedly would abridge substantive rights protected by Maine law.

The flaw in this argument is that the action could not be maintained under Maine law. It is true that in *Forbes v.*

* In considering the appropriateness of the First Circuit's decision, it should also be noted that even if Congress enacted the legislation before it, the transactions at issue herein would be beyond Congress' definition of the boundaries of the public's interest in railroads. The pending bills would empower the Commission to forbid any intercorporate transaction it found "is impairing or threatens to impair the ability of the affected carrier to properly perform its service to the public" (H.R. 11092, 93d Cong., 1st Sess. § 5). As pointed out in Point III, *supra*, no allegation is made that the transactions alleged by respondents impaired or threatened to impair BAR's ability to properly provide service.

Wells Beach Casino, Inc., 307 A.2d 210 (Me. 1973), the Supreme Judicial Court held that non-contemporaneous stock ownership is not an absolute bar to a derivative suit in the exceptional case where both the corporation and the non-contemporaneous share owner have suffered separate and distinct injuries from the alleged acts of corporate waste. In that case, however, the Supreme Judicial Court specifically reaffirmed its earlier holding in *Hyams v. Old Dominion Company*, 113 Me. 294, 93 A. 747 (1915) that a stockholder whose vendor participated or acquiesced in the wrong for which recovery is sought would be barred from bringing suit. Since Amoskeag's vendor was Bangor Punta, Maine law would thus bar it from instituting this action as absolutely as Federal Rule of Civil Procedure 23.1. Moreover, Maine has now by statute adopted the contemporaneous ownership rule (App. 34), and thus at the present time is in complete harmony with the federal rules.

Respondents apparently do not seriously press this contention, since under the same subheading (Resp. Br. 28-29) they assert that dismissal of the instant action would be of no effect because assertedly the less than 1% minority who are contemporaneous stockholders could cause the railroad to bring the action and recover the full amount claimed. Again respondents are in error. The rule, as set forth in Fletcher, *Cyclopedia of Corporations*, is that while pro-rata recovery is not ordinarily decreed, one of the circumstances in which pro-rata recovery is appropriate is where, as here, "the shares of the defendants are sold to outsiders who would then get an undeserved windfall if recovery is ordered to the corporation", 13 Fletcher, *Cyc. Corp.*, (perm. ed., 1963 rev.) Sec. 6028. See also *Perlman v. Feldman*, 219 F.2d 173 (2d Cir. 1955); *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 100 A. 645 (1917); *Joyce v. Congdon*, 114 Wash. 239, 195 P.29 (1921). In any case the issue is irrelevant to the present action, which is not brought by the less than 1% minority, and does not affect their rights.

V. Remand To The First Circuit For Further Argument Is Inappropriate.

Sensing the weakness of their contentions and the First Circuit's opinion, respondents suggest in their conclusion (Resp. Br. 32) that the Court remand the case to the First Circuit for a determination whether the *Home Fire* rule is applicable to claims under the federal antitrust and securities laws.

The suggested remand is unnecessary because it is not necessary to invoke *Home Fire* to bar the federal claims. Respondents cite no statutory provision permitting suit under the antitrust or securities laws by uninjured parties, and this Court has held that in the absence of such a statutory provision, an action by an uninjured party may not constitutionally be maintained in the federal courts. *Linda R.S. v. Richard D.*, 410 U.S. 614 (1973). Moreover, as the District Court noted (App. 33), Federal Rule of Civil Procedure 23.1 applies directly to the federal claims.

Conclusion

The order of the Court of Appeals for the First Circuit should be reversed, and the order of the District Court for the District of Maine reinstated.

Respectfully submitted,

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APPENDIX



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APPENDIX A

BANGOR AND AROOSTOOK RAILROAD COMPANY

R.F.D. No. 2, Box 14

Bangor, Maine 04401

June 28, 1973

To the Stockholders:

It is a pleasure to enclose a dividend check in the amount of \$1.00 for each share of Bangor and Aroostook Railroad Company common stock that you hold. This dividend, payable June 28, 1973, was declared by your Board of Directors on June 11, 1973. The company's last dividend was paid on December 29, 1967, and amounted to 20¢ per share.

This dividend has been declared because of satisfactory profits and over-all financial condition of the Bangor and Aroostook Railroad Company. Future dividends will be declared and paid only after careful examination of conditions then in existence. Earnings of \$1,508,368 and \$1,502,354 were reported for the years 1971 and 1972 respectively. The railroad experienced a small loss in 1968, a profit of \$175,487 in 1969 and a loss of \$807,647 in 1970. Figures for all years exclude intercompany dividends. The management of this railroad is proud of being the only Northeastern Carrier with the ability to pay a dividend.

During the years 1968 through 1972, the railroad made net additions and betterments to its property of \$8,903,813. Series "A" First Mortgage Bonds with a par value of \$5,586,000, which would have matured on February 1, 1976, have been retired at a reacquisition cost of \$4,543,400. Funds for buying in these bonds were derived from relatively short-term bank loans which must be refinanced on a long-term basis.

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Earnings for the first five months of 1973 compared with the same period of 1972 were:

	<u>1973</u>	<u>1972</u>
Operating Revenues	\$6,174,481	\$6,388,726
Operating Expenses & Taxes ..	7,107,960	6,873,985
Rwy. Operating Income ...	(933,479)	(485,259)
Equipment Rent Income	1,994,937	1,808,485
Other Income (net)	87,751	103,968
Avail. Fixed & Cont. Chgs.	1,149,209	1,427,194
Fixed Charges	616,247	586,269
Income after Fixed Charges ...	532,962	840,925
Prov. Federal Income Tax	—	248,100
Net Ordinary Income*	532,962	592,825

*Excluding intercompany dividends.

Best regards,

ALAN G. DUSTIN

Executive Vice President

For the Board of Directors

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BANGOR AND AROOSTOOK RAILROAD COMPANY

R.F.D. No. 2, Box 14

Bangor, Maine 04401

October 29, 1973

To the Stockholders:

On October 16, 1973, the Board of Directors of your Company declared a dividend of \$1.00 for each share of Bangor and Aroostook Railroad Company common stock payable on December 14, 1973, to Stockholders of Record on December 7, 1973, out of prior year retained earnings.

The financial health of your Company is excellent. During the first eight months of 1973, it has made capital improvements of \$483,000, retired outstanding debt amounting to \$3,269,100 and paid a dividend of \$1.00 per share (\$179,810) on June 28.

Earnings for the first eight months of 1973 compared with the same period of 1972 were:

	<u>1973</u>	<u>1972</u>
Operating Revenues	\$ 9,417,353	\$ 9,186,214
Operating Expenses & Taxes ..	11,213,676	10,663,142
Rwy. Operating Income ...	(1,796,323)	(1,476,928)
Equipment Rent Income	3,097,096	3,055,841
Other Income (net)	153,388	128,912
Avail. Fixed & Cont. Chgs.	1,454,161	1,707,825
Fixed Charges	980,956	952,542
Income after Fixed Charges ...	473,205	755,283
Prov. Federal Income Tax	—	19,600
Net Ordinary Income*	473,205	735,683

*Excluding intercompany dividends.

Best regards,

WALTER E. TRAVIS

Executive Vice President

For the Board of Directors

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APPENDIX B

H. R. 11092 is identical to its companion bill, S. 2460, introduced by Senators Magnuson and Cotton and referred to the Committee on Commerce. Only those portions relevant to rail carriers have been printed in this Appendix.

93^d CONGRESS
1ST SESSION

H. R. 11092

IN THE HOUSE OF REPRESENTATIVES

OCTOBER 24, 1973

Mr. STAGGERS (for himself and Mr. DEVINE) introduced the following bill; which was referred to the Committee on Interstate and Foreign Commerce

A BILL

To amend the Interstate Commerce Act, to grant additional authority to the Interstate Commerce Commission regarding conglomerate holding companies involving carriers subject to the jurisdiction of the Commission and noncarriers, and for other purposes.

- 1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That section 5(2)(a) of the Interstate Commerce Act
4 (49 U.S.C. 5(2)(a)) is amended by striking out the
5 period at the end of subparagraph (ii) and inserting in lieu
6 thereof “; or” and by adding at the end thereof the follow-
7 ing new subparagraph:
8 “(iii) for any person which is not a carrier, or two

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1 or more such persons jointly, to acquire control through
2 ownership of its stock or otherwise of a carrier by rail-
3 road, the operating revenues of which exceeded \$5,000,
4 000 or of a carrier other than a carrier by railroad, the
5 operating revenues of which exceeded \$1,000,000 for
6 a period of twelve consecutive months preceding the
7 date of the agreement of the parties covering the
8 transaction."

9 SEC. 2. The first and second sentences of section 5(3)
10 of the Interstate Commerce Act (49 U.S.C. 5(3)) are
11 amended to read as follows: "Whenever a person which is
12 not a carrier is authorized by an order entered under para-
13 graph (2), to acquire control, or whenever a person which
14 is not a carrier is found by the Commission to be in con-
15 trol of any carrier by railroad, the operating revenues of
16 which exceeds \$5,000,000 or of a carrier other than a car-
17 rier by railroad, the operating revenues of which exceed
18 \$1,000,000 annually, or of two or more carriers, such per-
19 son thereafter shall, to the extent provided by order of the
20 Commission be considered as a carrier subject to such of
21 the following provisions as are applicable to any carrier in-
22 volved in such acquisition of control: section 20 (1) to
23 (10), inclusive, of this part, sections 204(a) (1) and (2)
24 and 220 of part II, and section 313 of part III (which
25 relate to reports, accounts, and so forth, of carriers), and

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1 section 20a (2) to (11), inclusive, of this part, and sec-
2 tion 214 of part II (which relate to issues of securities and
3 assumptions of liability of carriers), including in each case
4 the penalties applicable in the case of violations of such
5 provisions. To the extent, if any, and at such time as the
6 Commission orders the application of such provisions of sec-
7 tion 20a of this part or section 214 of part II, in the case of
8 any such person, the Commission shall authorize the issue
9 or assumption applied for (a) if it finds that such issue or
10 assumption is for a purpose unrelated to the activities of any
11 carrier under the control of such person, subject, however, to
12 concurrent jurisdiction to be exercised by the Securities and
13 Exchange Commission, or (b) if it finds that such issue or
14 assumption is (i) for a purpose related to the activities of
15 any carrier under the control of such person, (ii) is con-
16 sistent with the proper performance of service to the public
17 by each carrier under the control of such person, and (iii)
18 will not impair the ability of any such carrier to perform
19 such service."

20 SEC. 3. Section 5(3) of the Interstate Commerce Act
21 (49 U.S.C. 5(3)) is amended by inserting "(a)" imme-
22 diately after "(3)" and by adding at the end thereof the
23 following new subparagraph:

24 "(b) Whenever in the performance of its duties under
25 section 12, section 20, and section 204(a)(7) of this Act to

1 inquire into the management of the business of any carrier
2 by railroad, the operating revenues of which exceed \$5,000
3 000 annually, or a carrier other than a carrier by railroad
4 the operating revenues of which exceed \$1,000,000 an-
5 nually, the Commission determines as a result of such in-
6 quiry that there is reason to believe that dealings or trans-
7 actions involving the receipt and expenditures of moneys,
8 transfers of land and buildings, or equipment, or other deal-
9 ings (other than those involving issuances of securities as
10 provided in section 20a of part I or section 214 of part II)
11 between any such carrier and any person controlling, con-
12 trolled by, or under common control with such carrier, or any
13 affiliate of such person, may result in impairment of the op-
14 erations of the carrier or its ability to respond to the needs of
15 the public, the Commission may issue an order to any such
16 carrier to show cause why all such dealings and transactions
17 should not be submitted to the Commission for approval or
18 disapproval. The Commission may, after hearing, require by
19 order any such carrier to file an application for approval of
20 any dealings or transactions aforesaid until further order by
21 the Commission, or require by order such other action, in-
22 cluding divestiture of control, as contemplated by section
23 5(17) of this Act.”

24 Sec. 4. Section 5(4) of the Interstate Commerce Act
25 (49 U.S.C. 5(4)) is amended to read as follows:

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1 “(4) It shall be unlawful for any person, except as
2 provided in paragraph (2), to enter into any transactions
3 within the scope of subparagraph (a) thereof, or to ac-
4 complish or effectuate, or to participate in accomplishing
5 or effectuating, the control or management of a carrier or
6 of two or more carriers, however such result is attained,
7 whether directly or indirectly, by use of common directors,
8 officers, or stockholders, a holding or investment company
9 or companies, a voting trust or trusts, or in any other man-
10 ner whatsoever. It shall be unlawful to continue to maintain
11 control or management accomplished or effectuated after the
12 enactment of this amendatory paragraph and in violation of
13 its provisions. As used in this paragraph and paragraph (5),
14 the words ‘control or management’ shall be construed to in-
15 clude the power to exercise control or management. For the
16 purpose of this section, any person owning beneficially 10
17 per centum or more of the voting securities of a carrier shall
18 be presumed to be in control of such carrier unless the
19 Commission finds otherwise.”

20 SEC. 5. Section 5 of the Interstate Commerce Act (49
21 U.S.C. 5) is amended by adding at the end thereof the fol-
22 lowing new paragraph:

23 “(17) Whenever the Commission, after notice and
24 hearing, determines that control—of a carrier by another
25 carrier or two or more carriers, or by a person which is not

1 a carrier, or two or more persons—is being used in a manner
2 which is impairing or threatens to impair the ability of the
3 affected carrier properly to perform its service to the public,
4 it shall by order direct cessation of any actions or practices
5 of the controlling party or parties and direct such affirmative
6 conduct as in its judgment will enable any such carrier
7 properly to perform its service to the public, or, where warranted
8 by the facts and circumstances, the Commission shall
9 require such further action as in its opinion is necessary or
10 appropriate, including, among other things, the divestiture
11 of control of the carrier whose service to the public has been
12 impaired or threatened.”

13 Sec. 6. Section 20(5)) of the Interstate Commerce Act
14 (49 U.S.C. 20(5)) is amended by inserting “(a)” immediately
15 after “(5)” and by adding at the end thereof
16 the following new subparagraph:

17 “(b) Any person having legal or beneficial ownership,
18 as trustee or otherwise, of more than 1 per centum of any
19 class of the capital stock or capital, as the case may be, of
20 any carrier by railroad, the operating revenues of which
21 exceed \$5,000,000 annually or 5 per centum of any class of
22 the capital stock or capital, as the case may be, of any carrier
23 other than a carrier by railroad the operating revenues
24 of which exceed \$1,000,000 annually, shall submit at such
25 times and in such form as the Commission may require a

1 description of the shares of stock or other interest owned by
2 such person, and the amount thereof."

3 SEC. 7. Section 20(1) of the Interstate Commerce Act
4 (49 U.S.C. 20(1)) is amended to read as follows:

5 “(1) The Commission is hereby authorized to require
6 annual, periodical, or special reports from carriers, persons
7 controlling, controlled by or under a common control with
8 such carriers, lessors, and associations (as defined in this
9 section), to prescribe the manner and form in which such
10 reports shall be made, and to require from such carriers,
11 persons controlling, controlled by or under a common control
12 with such carriers, lessors, and associations specific and full,
13 true and correct answers to all questions upon which the
14 Commission may deem information to be necessary, classify-
15 ing such carriers, persons controlling, controlled by, or under
16 a common control with such carriers, lessors, and associations
17 as it may deem proper for any of these purposes. Such
18 annual reports shall give an account of the affairs of the
19 carrier, persons controlling, controlled by, or under common
20 control with such carrier, lessor, or association in such form
21 and details as may be prescribed by the Commission.”

22 SEC. 8. Section 20(3) of the Interstate Commerce Act
23 (49 U.S.C. 20(3)) is amended to read as follows:

24 “(3) The Commission may, in its discretion, for the
25 purpose of enabling it the better to carry out the purposes

1 of this part, prescribe a uniform system of accounts appli-
2 cable to any class of carriers subject thereto, persons con-
3 trolling, controlled by or under common control with such
4 carriers, and a period of time within which such class shall
5 have such uniform system of accounts, and the manner in
6 which such accounts shall be kept."

7 Sec. 9. Section 20(5)(a) of the Interstate Commerce
8 Act (49 U.S.C. 20(5)(a)) as so redesignated by section 6
9 of this Act, is amended to read as follows:

10 “(5)(a) The Commission may, in its discretion, pre-
11 scribe the forms of any and all accounts, records, and mem-
12 oranda to be kept by carriers, persons controlling, controlled
13 by, or under common control with such carriers, and their
14 lessors, including the accounts, records, and memoranda of
15 the movement of traffic, as well as the receipts and expendi-
16 tures of moneys, and it shall be unlawful for such carriers,
17 persons controlling, controlled by, or under common control
18 with such carriers, or lessors to keep any accounts, records,
19 and memoranda contrary to any rules, regulations, or orders
20 of the Commission with respect thereto. The Commission or
21 any duly authorized special agent, accountant, or examiner
22 thereof shall at all times have authority to inspect and copy
23 any and all accounts, books, records, memoranda, corre-
24 spondence, and other documents of such carriers, persons
25 controlling, controlled by, or under common control with any

1 such carriers, lessors, and associations. The Commission or its
2 duly authorized special agents, accountants, or examiners
3 shall at all times have access to all lands, buildings, or equip-
4 ment of such carriers, persons controlling, controlled by, or
5 under common control with such carriers, or lessors, and
6 shall have authority under its order to inspect and examine
7 any and all such lands, buildings, and equipment. Such car-
8 riers, persons controlling, controlled by, or under common
9 control with such carriers, lessors, and other persons shall
10 submit their accounts, books, records, memoranda, corre-
11 spondence, and other documents for the inspection and copy-
12 ing authorized by this paragraph, and such carriers, persons
13 controlling, controlled by, or under common control with
14 such carriers, and lessors shall submit their lands, buildings,
15 and equipment to inspection and examination, to any duly
16 authorized special agent, accountant, or examiner of the
17 Commission, upon demand and the display of proper
18 credentials."

19 SEC. 10. Section 20a(3) of the Interstate Commerce
20 Act (49 U.S.C. 20a(3)) is amended by striking out the
21 period at the end thereof and inserting the following:
22 "*Provided, however, That in the case of a person consid-*
23 *ered a carrier pursuant to section 5(3) of this part, modifi-*
24 *cations, terms, or conditions may be specified only after a*

1 finding by the Commission that, otherwise, the proposed
2 issue or assumption of securities would not be consistent
3 with the proper performance of service to the public by
4 each carrier which is under the control of such person and
5 would impair the ability of any such carrier to perform such
6 service in the absence of such modification, terms, or
7 conditions.".

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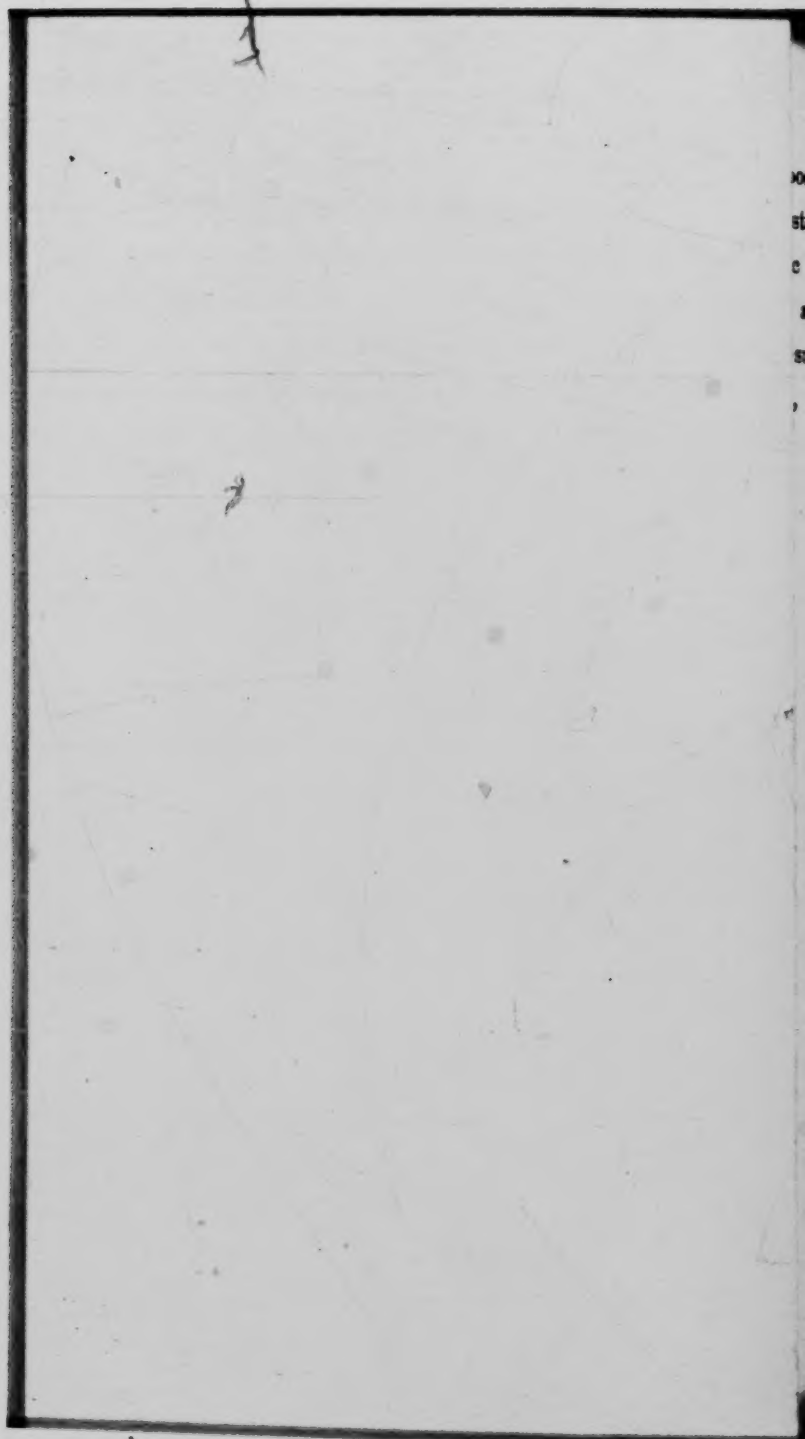
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NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

BANGOR PUNTA OPERATIONS, INC., ET AL. v. BANGOR & AROOSTOOK RAILROAD CO. ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

No. 73-718. Argued April 15, 1974—Decided June 19, 1974

In 1964 petitioner Bangor Punta Corp. (Bangor Punta), through its wholly-owned subsidiary, acquired 98.3% of the outstanding stock of respondent Bangor & Aroostook Railroad Co. (BAR), a Maine railroad, by purchasing all the assets of BAR's holding company, Bangor & Aroostook Corp. (B & A). From 1964 to 1969 Bangor Punta controlled and directed BAR. In 1969 Bangor Punta, again through its subsidiary, sold all its BAR stock to Amoskeag Co., which then assumed responsibility for BAR's management and later acquired additional shares to give it 99% ownership of the outstanding stock. In 1971, BAR and its subsidiary filed an action against Bangor Punta and its subsidiary, alleging various acts of corporate mismanagement of BAR during the period of control from 1960 through 1967 by Bangor Punta and B & A, and seeking damages for violations of the federal antitrust and securities laws, the Maine Public Utilities Act, and the common law of Maine. The District Court first noted that Amoskeag, the owner of more than 99% of the BAR shares, would be the principal beneficiary of any recovery, was thus the real party in interest, and that since Amoskeag had acquired its BAR stock long after the alleged wrongs had occurred, any recovery by it would be a windfall. The District Court then dismissed the action on the ground that since Amoskeag would have been barred from maintaining a shareholder derivative action due to its failure to satisfy the "contemporaneous ownership" requirement of both Fed. Rule Civ. Proc. 23.1 (b) (1), and state law, equitable principles precluded the use of the corporate fiction to evade that requirement. The Court of Appeals reversed primarily on the ground that in view of BAR's status as a "public" or "quasi

II BANGOR PUNTA OPERATIONS v. BANGOR & A. R. CO.

Syllabus

public" corporation and the important nature of the services it provides, any recovery by BAR would also inure to the public's benefit, a factor the court found to be sufficient to support a corporate cause of action and to render any windfall to Amoskeag irrelevant. *Held*:

1. The equitable principles that a stockholder, who has purchased all or substantially all the shares of a corporation from a vendor at a fair price, may not seek to have the corporation recover against that vendor for prior corporate mismanagement, and that the corporate entity may be disregarded if equity so demands, preclude respondent corporations from maintaining the action under either the federal antitrust and securities laws or state law. Pp. 6-10.

(a) Amoskeag, having purchased 98.3% of the stock of BAR from Bangor Punta and alleging no fraud, has no standing in equity to maintain this action for alleged corporate mismanagement. *Home Fire Insurance Co. v. Barber*, 67 Neb. 644, 93 N. W. 1024. Pp. 7-8, 9-10.

(b) As the principal beneficiary of any recovery and itself estopped from complaining of petitioners' alleged wrongs, Amoskeag cannot avoid the command of equity through the guise of proceeding in the name of respondent corporations which it owns and controls. Pp. 8-9, 10.

2. The Court of Appeals' assumption that any recovery would necessarily benefit the public is unwarranted and also overlooks the fact that Amoskeag, the actual beneficiary of any recovery, would be unjustly enriched since it has sustained no injury. Neither the federal antitrust and securities laws nor the applicable state laws contemplate a windfall recovery by Amoskeag in these circumstances. Pp. 10-12.

3. Deterrence of railroad mismanagement is not in itself a sufficient ground for allowing respondents to recover. If such deterrence were the only objective, it would suffice if any plaintiff was willing to file a complaint, and no injury or violation of a legal duty to the particular plaintiff would have to be alleged. Pp. 12-13.

482 F. 2d 865, reversed.

POWELL, J., delivered the opinion of the Court, in which BURGER, C. J., and STEWART, BLACKMUN, and REHNQUIST, JJ., joined. MARSHALL, J., delivered a dissenting opinion, in which DOUGLAS, BRENNAN, and WHITE, JJ., joined.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D.C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 73-718

Bangor Punta Operations,
Inc., et al., Petitioners,
v.
Bangor & Aroostook Railroad
Company et al.

On Writ of Certiorari to
the United States Court
of Appeals for the First
Circuit.

[June 19, 1974]

MR. JUSTICE POWELL delivered the opinion of the Court.

This case involves an action by a Maine railroad corporation seeking damages from its former owners for violations of federal antitrust and securities laws, applicable state statutes, and common-law principles. The complaint alleged that the former owners had engaged in various acts of corporate waste and mismanagement during the period of their control. The shareholder presently in control of the railroad acquired 98.3% of the railroad's shares from the former owners long after the alleged wrongs occurred. We must decide whether equitable principles applicable under federal and state law preclude recovery by the railroad in these circumstances.

I

Respondent Bangor and Aroostook Railroad Company (BAR), a Maine corporation, operates a railroad in the northern part of the State of Maine. Respondent Bangor Investment Company (BIC), also a Maine corporation, is a wholly-owned subsidiary a BAR. Petitioner Bangor Punta Corporation (Bangor Punta), a Delaware corporation, is a diversified investment com-

pany with business operations in several areas. Petitioner Bangor Punta Operations, Inc. (BPO), a New York corporation, is a wholly-owned subsidiary of Bangor Punta.

On October 13, 1964, Bangor Punta, through its subsidiary BPO, acquired 98.3% of the outstanding stock of BAR. This was accomplished by the subsidiary's purchase of all the assets of Bangor and Aroostook Corporation (B&A), a Maine corporation established in 1960 as the holding company of BAR. From 1964 to 1969, Bangor Punta controlled and directed BAR through its ownership of about 98.3% of the outstanding stock. On October 2, 1969, Bangor Punta, again through its subsidiary, sold all of its stock for \$5,000,000 to Amoskeag Company, a Delaware investment corporation. Amoskeag assumed responsibility for the management of BAR and later acquired additional shares to give it ownership of more than 99% of all the outstanding stock.

In 1971, BAR and its subsidiary filed the present action against Bangor Punta and its subsidiary in the United States District Court for the Northern District of Maine. The complaint specified 13 counts of alleged mismanagement, misappropriation, and waste of BAR's corporate assets occurring during the period from 1960 through 1967 when B&A and then Bangor Punta controlled BAR.¹ Damages were sought in the amount of \$7,000,000 for violations of both federal and state laws.

¹ Several of the alleged acts of corporate mismanagement occurred between 1960 and 1964 when B&A, BAR's holding company, was in control of the railroad. Liability for these acts was nevertheless sought to be imposed on Bangor Punta, even though it had no interest in either BAR or B&A during this period. The apparent basis for liability was the 1964 purchase agreement between B&A and Bangor Punta. The complaint in the instant case alleged that under the agreement Bangor Punta, through its subsidiary, assumed "all debts, obligations, contracts and liabilities" of B&A.

The federal statutes alleged to have been violated included § 10 of the Clayton Act, 15 U. S. C. § 20, § 10 (b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j (b), and Rule 10b-5, 7 CFR § 240.10b-5, as promulgated thereunder by the Securities and Exchange Commission. The state claims were ground on § 104 of the Maine Public Utilities Act, 35 M. R. S. A. § 104, and the common law of Maine.

The complaint focused on four intercompany transactions which allegedly resulted in injury to BAR.² Counts I and II averred the B&A, and later Bangor Punta, overcharged BAR for various legal, accounting, printing and other services. Counts III, IV, V, and VI averred that B&A improperly acquired the stock of the St. Croix Paper Company which BAR owned through its subsidiary. Counts VII, VIII, IX, and X charged that B&A and Bangor Punta improperly caused BAR to declare special dividends to its stockholders, including B&A and Bangor Punta, and also caused BAR's subsidiary to borrow in order to pay regular dividends. Counts XI, XII, and XIII charged that B&A improperly caused BAR to excuse payment by B&A and Bangor Punta of the interest due on a loan made by BAR to B&A. In sum, the complaint alleged that during the period of their control of BAR, Bangor Punta, and its predecessor in interest B&A, "exploited it solely for their own purposes" and "calculatedly drained the reserves of BAR in violation of the law for their own benefit."

The District Court granted petitioners' motion for summary judgment and dismissed the action. 353 F. Supp. 724 (1972). The court first observed that although the suit purported to be primary action

² Bangor Punta was alleged to have effected these transactions through its wholly-owned subsidiary BPO. For purposes of clarity, we shall attribute BPO's actions directly to Bangor Punta.

brought in the name of the corporation, the real party in interest and hence the actual beneficiary of any recovery, was Amoskeag, the present owner of more than 99% of the outstanding stock of BAR. The court then noted that Amoskeag had acquired all of its BAR stock long after the alleged wrongs occurred and that Amoskeag did not contend that it had not received full value for its purchase price, or that the purchase transaction was tainted by fraud or deceit. Thus, any recovery on Amoskeag's part would constitute a windfall because it had sustained no injury. With this in mind, the court then addressed the claims based on federal law and determined that Amoskeag would have been barred from maintaining a shareholder derivative action because of its failure to satisfy the "contemporaneous ownership" requirement of Fed. Rule Civ. Proc. 23.1 (b)(1).³ Finding that equitable principles prevented the use of the corporate fiction to evade the proscription of Rule 23.1, the court concluded that Amoskeag's efforts to recover under the Securities Exchange Act and the Clayton Antitrust Act must fail. Turning to the claims based on state law, the court recognized that the applicability of Rule 23.1 (b)(1) has been questioned where federal jurisdiction is based on diversity of citizenship.⁴ The court found it unnecessary

³ Rule 23.1 (b)(1), which specifies the requirements applicable to shareholder derivative actions, states that the complaint shall aver that "the plaintiff was a shareholder at the time of the transaction of which he complains. . . ." This provision is known as the "contemporaneous ownership" requirement. See 3B Moore's Federal Practice (2d ed. 1974) ¶ 23.1 *et seq.*

⁴ The "contemporaneous ownership" requirement in shareholder derivative actions was first announced in *Hawes v. Oakland*, 104 U. S. 450 (1882), and soon thereafter adopted as Equity Rule 97. This provision was later incorporated in Equity Rule 27 and finally in the present Rule 23.1. After the decision in *Erie R. Co. v. Tompkins*, 304 U. S. 64 (1938), the question arose whether the contemporane-

to resolve this issue, however, since its examination of state law indicated that Maine probably followed the "prevailing rule" requiring contemporaneous ownership in order to maintain a shareholder derivative action. Thus, whether the federal rule or state substantive law applied, the present action could not be maintained.

The United States Court of Appeals for the First Circuit reversed. 482 F. 2d 865 (1973). The court stated that its disagreement with the District Court centered primarily on that court's assumption that Amoskeag would be the "sole beneficiary" of any recovery by BAR. The Court of Appeals thought that in view of the railroad's status as a "public" or "quasi-public" corporation and the important nature of the services it provides, any recovery by BAR would also inure to the benefit of the public. The court stated that this factor sufficed to support a corporate cause of action and rendered any wind-fall to Amoskeag irrelevant. In addition, the court noted that to permit BAR to recover for the alleged wrongs would provide a needed deterrent to "patently undesirable conduct" in the management of railroads. *Id.*, at 871. Finally, the court confronted the possibility that any corporate recovery might be diverted to enrich the present BAR shareholders, mainly Amoskeag, rather than re-invested to improve the railroad's services for the benefit of the public. Although troubled by this prospect, the court concluded that the public interest would nonetheless be better served by insuring that petitioners would not be immune to civil liability for their allegedly wrong-

ous ownership requirement was one of procedure or substantive law. If the requirement were substantive, then under the regime of *Erie* it could not be validly applied in federal diversity cases where state law permitted a noncontemporaneous shareholder to maintain a derivative action. See 3B Moore's Federal Practice, ¶ 23.1.01-23.1.15 [2]. Although most cases treat the requirement as one of procedure, this Court has never resolved the issue. *Ibid.*

ful conduct. Without deciding the issue, the court also suggested the possibility of devising "court-imposed limitations" on the use BAR might make of any recovery to insure that the public would actually be benefitted.

We granted petitioners' application for certiorari. — U. S. —. We now reverse.

II

A

We first turn to the question whether respondent corporations may maintain the present action under § 10 of the Clayton Antitrust Act, 15 U. S. C. § 20, § 10 (b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j (b), and Rule 10b-5, 17 CFR § 240.10b-5. The resolution of this issue depends upon the applicability of the settled principle of equity that a shareholder may not complain of acts of corporate mismanagement if he acquired his shares from those who participated or acquiesced in the allegedly wrongful transactions. See, *e. g.*, *Bloodworth v. Bloodworth*, 225 Ga. 379, 387, 169 S. E. 2d 150, 156-157 (1969); *Bookman v. R. J. Reynolds Tobacco Co.*, 138 N. J. Eq. 312, 372, 48 A. 2d 646, 680 (Ch. 1946); *Babcock v. Farwell*, 245 Ill. 14, 40-41, 91 N. E. 683, 692-693 (1910).⁵ This principle has been invoked with special force where a shareholder purchases all or substantially all the shares of a corporation from a vendor at a fair price, and then seeks to have the corporation recover against that vendor for prior corporate mismanagement. See, *e. g.*, *Matthews v. Headley Chocolate Co.*, 130 Md.

⁵ This principle obtains in the great majority of jurisdictions. See, *e. g.*, *Russell v. Louis Melind Co.*, 311 Ill. App. 182, 72 N. E. 2d 869 (1947); *Klum v. Clinton Trust Co.*, 183 Misc. 340, 48 N. Y. S. 2d 267 (1944); *Clark v. American Coal Co.*, 86 Iowa 436, 53 N. W. 291 (1892); *Boldenweck v. Bullis*, 40 Colo. 253, 90 P. 634 (1907). See 13 Fletcher Cyc. Corp. § 5866 (1973 ed.); Ballentine on Corporations, § 148 (1946 ed.).

523, 532-535, 100 A. 645, 650-651 (1917); *Home Fire Insurance Co. v. Barber*, 67 Neb. 644, 661-662, 93 N. W. 1024, 1030-1031 (1903). See also *Amen v. Black*, 234 F. 2d 12, 23 (CA10 1956). The equitable considerations precluding recovery in such cases were explicated long ago by Dean (then Commissioner) Roscoe Pound in *Home Fire Insurance Co. v. Barber*, *supra*. Dean Pound, writing for the Supreme Court of Nebraska, observed that the shareholders of the plaintiff corporation in that case had sustained no injury since they had acquired their shares from the alleged wrongdoers after the disputed transactions occurred and had received full value for their purchase price. Thus, any recovery on their part would constitute a windfall, for it would enable them to obtain funds to which they had no just title or claim. Moreover, it would in effect allow the shareholders to recoup a large part of the price they agreed to pay for their shares, notwithstanding the fact that they received all they had bargained for. Finally, it would permit the shareholders to reap a profit from wrongs done to others, thus encouraging further such speculation. Dean Pound stated that these consequences rendered any recovery highly inequitable and mandated dismissal of the suit.

The considerations supporting the *Home Fire* principle are especially pertinent in the present case. As the District Court pointed out, Amoskeag, the present owner of more than 99% of the BAR shares, would be the principal beneficiary of any recovery obtained by BAR. Amoskeag, however, acquired 98.3% of the outstanding shares of BAR from petitioner Bangor Punta in 1969, well after the alleged wrongs were said to have occurred. Amoskeag does not contend that the purchase transaction was tainted by fraud or deceit, or that it received less than full value for its money. Indeed, it does not assert that it has sustained any injury at all. Nor does it appear

that the alleged acts of prior mismanagement have had any continuing effect on the corporations involved or the value of their shares.⁶ Nevertheless, by causing the present action to be brought in the name of respondent corporations, Amoskeag seeks to recover indirectly an amount equal to the \$5,000,000 it paid for its stock, plus an additional \$2,000,000. All this would be in the form of damages for wrongs petitioner Bangor Punta is said to have inflicted, not upon Amoskeag, but upon respondent corporations during the period in which Bangor Punta owned 98.3% of the BAR shares. In other words, Amoskeag seeks to recover for wrongs Bangor Punta did to itself as owner of the railroad.⁷ At the same time it reaps this windfall, Amoskeag desires to retain all its BAR stock. Under *Home Fire*, it is evident that Amoskeag would have no standing in equity to maintain the present action.⁸

⁶ In *Home Fire*, Dean Pound suggested that equitable principles might not prevent recovery where the effects of the wrongful acts continued and resulted in injury to present shareholders. 67 Neb. 644, 662, 93 N. W. 1024, 1031. In their complaint in the instant case, respondents alleged that "[t]he injury to BAR is a continuing one surviving the aforesaid sale [from petitioner BPO] to Amoskeag." The District Court noted that respondents alleged no facts to support this contention and therefore found any such exception inapplicable. 353 F. Supp., at 727 n. 1. Respondents apparently did not renew this contention on appeal.

⁷ Similarly, as to the period before October 1964, Amoskeag seeks to recover for wrongs B&A and its shareholders did to *themselves* as owners of the railroad.

⁸ Conceding the lack of equity in any recovery by Amoskeag, the dissent argues that the present action can nevertheless be maintained because there are 20 minority shareholders, holding less than 1% of the BAR stock, who owned their shares "during the period from 1960 through 1967 when the transactions underlying the railroad's complaint took place, and who still owned that stock in 1971 when the complaint was filed." *Post*, at 4. The dissent would conclude that the existence of these innocent minority shareholders entitles

We are met with the argument, however, that since the present action is brought in the name of respondent corporations, we may not look behind the corporate entity to the true substance of the claims and the actual beneficiaries. The established law is to the contrary. Although a corporation and its shareholders are deemed separate entities for most purposes, the corporate form may be disregarded in the interests of justice where it is used to defeat an overriding public policy. *New Colonial Ice Co., Inc. v. Helvering*, 292 U. S. 435, 442 (1934); *Chicago M. & St. P. R. Co. v. Minn. Civic Assn.*, 247 U. S. 490, 501 (1918). In such cases, courts of equity, piercing all fictions and disguises, will deal with the substance of the action and not blindly adhere to the corporate form. Thus, where equity would preclude the shareholders from maintaining an action in their own right, the corporation would also be precluded. *Amen v. Black*, 234 F. 2d 12 (CA10 1956); *Capital Wine and Spirit Corp. v. Pokrass*, 277 App. Div. 184, 98 N. Y. S. 2d 291 (1st Dept. 1950), *aff'd*, 302 N. Y. 734, 98 N. E. 2d 704 (1951); *Matthews v. Headley Chocolate Co.*, *supra*; *Home Fire Insurance Co. v. Barker*, *supra*. It follows that Amoskeag, the principal beneficiary of any recovery and itself estopped from complaining of petitioners' alleged wrongs, cannot avoid the command of equity through the guise of

BAR, and hence Amoskeag, to recover the entire \$7,000,000 amount of alleged damages.

Aside from the illogic in such an approach, the dissent's position is at war with the precedents, for the *Home Fire* principle has long been applied to preclude full recovery by a corporation even where there are innocent minority shareholders who acquired their shares prior to the alleged wrongs. See cases cited at n. 5, *supra*, and accompanying text. The dissent also mistakes the factual posture of this case, since the respondent corporations did not institute this action for the benefit of the minority shareholders. See discussion at n. 15, *infra*.

proceeding in the name of respondent corporations which it owns and controls.

B

Respondents fare no better in their efforts to maintain the present actions under state law, specifically Section 104 of the Maine Public Utilities Act, 35 M. R. S. A. § 104, and the common law of Maine. In *Forbes v. Wells Beach Casino, Inc.*, — Me., —, 307 A. 2d 210, 223 n. 10 (1973), the Maine Supreme Court recently declared that it had long accepted the equitable principle that a "stockholder has no standing if either he or his vendor participated or acquiesced in the wrong. . . ." See *Hyams v. Old Dominion Co.*, 113 Me. 294, 302, 93 A. 747 (1915).⁹ Thus, Amoskeag would be barred from maintaining the present action under Maine law since it acquired its shares from petitioners, the alleged wrongdoers. Moreover, the principle that the corporate entity may be disregarded if equity so demands is accepted by Maine precedents. See, e. g., *Bonnar-Vawter, Inc. v. Johnson*, 157 Me. 380, 173 A. 2d 141, 145 (1961).

III

In reaching the contrary conclusion, the Court of Appeals stated that it could not accept the proposition that Amoskeag would be the "sole beneficiary" of any recovery by BAR. 482 F. 2d, at 868. The court noted

⁹ In addition, the new Maine Business Corporation Act adopts the contemporaneous ownership requirement for shareholder derivative actions. See 13-A M. R. S. A. § 627 (1)(A) (1972). This provision apparently became effective two days after the present action was filed. As the District Court noted, it is an open question whether Maine in fact had a contemporaneous ownership requirement prior to that time. 353 F. Supp., at 727. See Field, McKusick & Wroth, *Maine Civil Practice* (2d ed. 1970) § 23.2, at 393. In the absence of any indication that Maine would not have followed the "prevailing view," the District Court determined that the contemporaneous ownership requirement of Fed. Rule Civ. Proc. 23.1 applied.

that in view of the railroad's status as a "quasi-public" corporation and the essential nature of the services it provides, the public had an identifiable interest in BAR's financial health. Thus, any recovery by BAR would accrue to the benefit of the public through the improvement in BAR's economic position and the quality of its services. The court thought that this factor rendered any windfall to Amoskeag irrelevant.

At the outset, we note that the Court of Appeals' assumption that any recovery would necessarily benefit the public is unwarranted. As that court explicitly recognized, any recovery by BAR could be diverted to its shareholders, namely Amoskeag, rather than re-invested in the railroad for the benefit of the public. *Id.*, at 871. Nor do we believe this possibility can be avoided by respondents' suggestion that the District Court impose limitations on the use BAR might make of the recovery.¹⁰ There is no support for such a result under either federal or state law. BAR would be entitled to distribute the recovery in any lawful manner it may choose, even if such distribution resulted only in private enrichment. In sum, there is no assurance that the public would receive any benefit at all from these funds.

The Court of Appeals' position also appears to overlook the fact that Amoskeag, the actual beneficiary of any recovery through its ownership of more than 99% of the BAR shares, would be unjustly enriched since it has sustained no injury.¹¹ It acquired substantially all the BAR

¹⁰ The Court of Appeals noted that its decision "is not conditioned on the devising of court-imposed limitations on the uses of any corporate recovery." 482 F.2d, at 871. Counsel for respondents also admitted at oral argument that BAR had no legal obligation to use its recovery to improve the railroad's services in order to benefit the public. Tr. of Oral Arg. 17.

¹¹ The unjust enrichment of Amoskeag is inevitable. As the owner of more than 99% of the BAR shares, Amoskeag would obviously

shares from Bangor Punta subsequent to the alleged wrongs and does not deny that it received full value for its purchase price. No fraud or deceit of any kind is alleged to have been involved in the transaction.¹² The equitable principles of *Home Fire* preclude Amoskeag from reaping a windfall by enhancing the value of its bargain to the extent of the entire purchase price plus an additional \$2,000,000. Amoskeag would in effect have acquired a railroad worth \$12,000,000 for only \$5,000,000. Neither the federal antitrust or securities laws nor the applicable state laws contemplate recovery by Amoskeag in these circumstances.¹³

benefit from any increase in the value of its investment. Here, the increased value would be of dramatic proportions, with an influx of \$7,000,000 into a railroad purchased for only \$5,000,000. The dissent's suggestion that this substantial infusion of capital, if devoted to "plant and equipment," would not enhance "earning capacity" or "balance sheet strength" (*post*, at 7) will come as a surprise to regulatory bodies, railroad management, and investors.

Respondents have also conceded, both in their brief and at oral argument, that the present action could not be maintained if Amoskeag were the real party in interest, or alternatively, if only an unregulated private corporation were involved. Brief for Respondents, pp. 28-29; Tr. of Oral Arg. 19-20.

¹² The dissent's suggestion (*post*, at 5-6) that Amoskeag, a highly sophisticated investor, was defrauded in the purchase transaction and that it has suffered an injury is without support in the record. Not even Amoskeag has ever so asserted, in either the complaint, the briefs, or at oral argument. And in granting the motion for summary judgment, the District Court expressly observed that Amoskeag did not contend that it was defrauded in the purchase transaction. 353 F. Supp., at 726. This statement has since stood uncontroverted by Amoskeag. In short, prior to the dissent today, it has never been alleged or suggested that Amoskeag did not acquire exactly what it bargained for in this transaction.

¹³ The dissent makes much of the supposed public interest in railroads and the power of a court of equity to ensure that the public will actually be benefited by any recovery. *Post*, at 6-7, 9-12. This argument misses the point. To begin with, the present action is, in substance, a typical derivative suit seeking an accounting from

The Court of Appeals further stated that it was important to insure that petitioners would not be immune from liability for their wrongful conduct and noted that BAR's recovery would provide a needed deterrent to mismanagement of railroads. Our difficulty with this argument is that it proves too much. If deterrence were the only objective, then in logic any plaintiff willing to file a complaint would suffice. No injury or violation of a legal duty to the particular plaintiff would have to be alleged. The only prerequisite would be that the plaintiff agree to accept the recovery, lest the supposed wrongdoer be allowed to escape a reckoning. Suffice it to say that we have been referred to no authority which would support so novel a result, and we decline to adopt it.¹⁴

the previous controlling shareholder for various acts of corporate waste and mismanagement. It is settled law that the fiduciary duty owed by a controlling shareholder extends primarily to those who have a tangible interest in the corporation. Similarly, the recovery provided is intended to compensate, not the public generally, but those who have been injured as a result of a breach of a duty owed to them. In the present case, however, the actual beneficiary of any recovery, Amoskeag, has suffered neither an injury nor a breach of any legal duty. In short, Amoskeag has no cause of action.

The dissent argues that respondents' complaint is based on federal antitrust and securities statutes and that such laws are designed in part to benefit the public. With that much we agree. But the statutory design has not been effectuated through the indiscriminate provision of causes of action to every citizen. Rather, these statutes create specifically defined legal duties to particular plaintiffs and vest the appropriate causes of action in them alone. Here, the statutorily designated plaintiffs are respondent corporations. But, as we have stated, these plaintiffs cannot maintain the present action because a recovery by Amoskeag would violate established principles of equity.

¹⁴ As Dean Pound stated in reply to a similar argument in *Home Fire*:

"But it is said the defendant Barber, by reason of his delinquencies, is in no position to ask that the court look behind the corporation to the real and substantial parties in interest. . . . We do not think

We therefore conclude that respondent corporations may not maintain the present action.¹⁵ The judgment of the Court of Appeals is reversed.

So ordered.

such a proposition can be maintained. It is not the function of courts of equity to administer punishment. When one person has wronged another in a matter within its jurisdiction, equity will spare no effort to redress the person injured, and will not suffer the wrongdoer to escape restitution to such person through any device or technicality. But this is because of its desire to right wrongs, not because of a desire to punish all wrongdoers. If a wrongdoer deserves to be punished, it does not follow that others are to be enriched at his expense by a court of equity. A plaintiff must recover on the strength of his own case, not on the weakness on the defendant's case. It is his right, not the defendant's wrongdoing, that is the basis of recovery. When it is disclosed that he has no standing in equity, the degree of wrongdoing of the defendant will not avail him." 67 Neb., at 673, 93 N. W., at 1035.

¹⁵ Our decision rests on the conclusion that equitable principles preclude recovery by Amoskeag, the present owner of more than 99% of the BAR shares. The record does not reveal whether the minority shareholders who hold the remaining fraction of 1% of the BAR shares stand in the same position as Amoskeag. Some courts have adopted the concept of a pro-rata recovery where there are innocent minority shareholders. Under this procedure, damages are distributed to the minority shareholders individually on a proportional basis, even though the action is brought in the name of the corporation to enforce primary rights. See, e. g., *Matthews v. Headley Chocolate Co.*, 130 Md. 523, 536-540, 100 A. 645, 650-652 (1917). In the present case, respondents have expressly disavowed any intent to obtain a pro-rata recovery on behalf of the 1% minority shareholders of BAR. We therefore do not reach the question whether such recovery would be appropriate.

The dissent asserts that the alleged acts of corporate mismanagement have placed BAR "close to the brink of bankruptcy" and that the present action is maintained for the benefit of BAR's creditors. *Post*, at 8. With all respect, it appears that the dissent has sought to redraft respondents' complaint. As the District Court noted, respondents have not brought this action on behalf of any creditors. 353 F. Supp., at 726. Indeed, they have never so contended. Moreover, respondents have conceded that the financial health of the railroad is excellent. Tr. of Oral Arg. 18.

SUPREME COURT OF THE UNITED STATES

No. 73-718

Bangor Punta Operations,
Inc., et al., Petitioners,
v.
Bangor & Aroostook Railroad
Company et al.

On Writ of Certiorari to
the United States Court
of Appeals for the First
Circuit.

[June 19, 1974]

MR. JUSTICE MARSHALL, with whom MR. JUSTICE DOUGLAS, MR. JUSTICE BRENNAN, and MR. JUSTICE WHITE join, dissenting.

This suit, brought by and in the name of respondent railroad and its wholly owned subsidiary, seeks to recover damages for the conversion and misappropriation of corporate assets allegedly committed by petitioners, Bangor Punta and its wholly owned subsidiary, during a period when the latter was the majority shareholder of the railroad. Ordinarily, of course, a corporation may seek legal redress against those who have defrauded it of its assets. And when it does so, "A corporation and its stockholders are generally to be treated as separate entities. Only under exceptional circumstances . . . can the difference be disregarded." *Burnet v. Clark*, 287 U. S. 410, 415 (1932). See also *New Colonial Ice Co. v. Helvering*, 292 U. S. 435, 442 (1934).

The Court finds such exceptional circumstances here because, in its view, any recovery had by the corporation will be a windfall to Amoskeag, the present owner of approximately 99% of the corporation's stock, who purchased most of that stock from the petitioners, the alleged wrongdoers. The Court therefore concludes that this suit must be barred under the equitable principles set forth in *Home Fire Insurance Co. v. Barber*, 67 Neb. 644, 93 N. W. 1024 (1903).

I cannot agree. Having read the precedents relied upon by the majority, I respectfully submit that they not only do not support, but indeed directly contradict the result reached today. While purporting to rely on settled principles of equity, the Court sadly mistakes the facts of this case and the established powers of an equity court. In my view, no windfall recovery to Amoskeag is inevitable, or even likely, on the facts of this case. But even if recovery by respondent would in fact be a windfall to Amoskeag, the Court disregards the interests of the railroad's creditors, as well as the substantial public interest in the continued financial viability of the Nation's railroads which have been so heavily plagued by corporate mismanagement, and ignores the powers of the court to impose equitable conditions on the corporation's recovery so as to insure that these interests are protected. The Court's decision is also inconsistent with prior decisions of this Court limiting the application of equitable defenses when they impede the vindication, through private damage actions, of the important policies of the federal antitrust laws.

I

The majority places primary reliance on Dean Pound's decision in *Home Fire Insurance Co. v. Barber*, *supra*. In that case, *all* of the shares of the plaintiff corporation had been acquired from the alleged wrongdoers after the transactions giving rise to the causes of action stated in the complaint. Since none of the corporation's shareholders were stockholders at the time of the alleged wrongful transactions, none had been injured thereby. Dean Pound therefore held that equity barred the corporation from pursuing a claim where none of its shareholders could complain of injury.

Dean Pound thought it clear, however, that the opposite result would obtain if *any* of the present shareholders "are entitled to complain of the acts of the defend-

ant and of his past management of the company; for if any of them are so entitled, there can be no doubt of the right and duty of the corporation to maintain this suit. It would be maintainable in such a case even though the wrong-doers continued to be stockholders and would share in the proceeds." 67 Neb., at 655, 93 N. W., at 1028. Cf. *Capitol Wine & Spirit Corp. v. Pokrass*, 277 App. Div. 184, 186, 98 N. Y. S. 2d 291, 293 (1st Dept. 1950), aff'd, 302 N. Y. 734, 98 N. E. 2d 704 (1951).

The rationale for the distinction drawn by Dean Pound is simple enough. The sole shareholder who defrauds or mismanages his own corporation hurts only himself. For the corporation to sue him for his wrongs is simply to take money out of his right pocket and put it in his left. It is therefore appropriate for equity to intervene to pierce the corporate veil. But where there are minority shareholders, misappropriation and conversion of corporate assets injures their interests as well as the interest of the majority shareholder. The law imposes upon the directors of a corporation a fiduciary obligation to all of the corporation's shareholders, and part of that obligation is to use due care to ensure that the corporation seek redress where a majority shareholder has drained the corporation's resources for his own benefit and to the detriment of minority shareholders.¹ Indeed, minority shareholders would be entitled to bring a derivative action, on behalf of the corporation, to enforce the corporation's right to recover for the injury done to it, if the directors

¹ See generally 3 Fletcher, *Cyclopedia Corporations* § 1012 (1965). Indeed, the failure to exercise reasonable care to seek redress for wrongs done the corporation might well subject the directors to personal liability. See, e. g., *Briggs v. Spaulding*, 141 U. S. 132 (1891); *Kavanaugh v. Commonwealth Trust Co. of New York*, 223 N. Y. 103, 119 N. E. 237 (1918).

turned down a request to seek relief.² And any recovery obtained in such an action would belong to the corporation, not the minority shareholders as individuals, for the shareholder in a derivative action enforces not his own individual rights, but rights which the corporation has. See *Meyer v. Fleming*, 327 U. S. 161, 167 (1946); *Ross v. Bernhard*, 396 U. S. 531, 538 (1970); *Koster v. Lumbermens Mut. Cas. Co.*, 339 U. S. 518, 522 (1947).

These elementary principles of corporate law should control this case. Although first Bangor Punta and then Amoskeag owned the great majority of the shares of respondent railroad, the record shows that there are many minority shareholders who owned BAR stock during the period from 1960 through 1967 when the transactions underlying the railroad's complaint took place, and who still owned that stock in 1971 when the complaint was filed.³ Any one of these minority shareholders would have had the right, during the 1960-1967 period, as well as thereafter, to bring a derivative action on behalf of the corporation against the majority shareholder for misappropriation of corporate assets. As Dean Pound states, such an action could be brought, "even though the wrongdoers continued to be stockholders and would share in the proceeds." 67 Neb., at 655, 93 N. W., at 1028.

² "[Stockholders' derivative suits] are one of the remedies which equity designed for those situations where the management, through fraud, neglect of duty or other cause declines to take the proper and necessary steps to assert the rights which the corporation has." *Meyer v. Fleming*, 327 U. S. 161, 167 (1946). And it is irrelevant that the shareholders bringing the derivative action own only a small percentage of the total outstanding shares. See *Ashwander v. Tennessee Valley Authority*, 297 U. S. 288, 318 (1936); *Subin v. Goldsmith*, 224 F. 2d 753, 761 (CA2), cert. denied, 350 U. S. 883 (1955).

³ According to the complaint, there were 20 individual minority shareholders, many of whom acquired their shares in the 1950's. App., at 6-7, 22-23.

It is ironic, then, to see the Court adopt a result which bars the corporation itself from bringing a suit which a minority shareholder could have brought in the corporation's behalf. And it is peculiar, to say the least, that the law should prevent the directors of BAR from fulfilling the fiduciary obligation to minority shareholders which the law devolves upon them. Such a result not only cannot be derived from *Home Fire*, but is directly in conflict with its holding.

II

Even assuming, however, that the equitable principles of *Home Fire* should be extended to the situation where the present majority shareholder does not own all the outstanding shares, there are other features distinguishing this case from *Home Fire* and calling for the recognition of the railroad's right to maintain this action. To begin with, it is not at all clear from the record that any recovery had by the railroad will in fact be a windfall to Amoskeag, its present majority shareholder.

The Court relies principally on its own observation that Amoskeag was not defrauded or deceived in its transaction with petitioners, that it received full value for its money, and that it has received no injury whatsoever. See *ante*, at 7. The record, in my view, simply will not support these "findings." That there is no specific allegation in the complaint that Amoskeag was deceived or otherwise injured by petitioners is understandable, since this lawsuit is not brought by Amoskeag, but rather by respondent railroad in its own name.

Furthermore, a fair reading of the complaint indicates that Amoskeag most likely has suffered injury. The causes of action relate primarily to transactions involving the railroad and its former majority stockholder between 1960 and 1967. Amoskeag purchased its shares from petitioners on October 2, 1969, after these events. But

nowhere in the record is there any concession that, at the time of its purchase, Amoskeag was fully aware of the misuses of corporate assets alleged in the complaint. To the contrary, the complaint asserts that at the time of Amoskeag's purchase, the Interstate Commerce Commission's Bureau of Accounts was in the middle of an investigation into the relationship between the railroad and its majority shareholder. Its report, not made public until July 1971, laid bare for the first time the wrongful intercorporate transactions that are the subject of the present suit and recommended that legal remedies be explored to require petitioners to pay back to the carrier assets taken without compensation and charges made where no services were performed. The plain import of the complaint is that Amoskeag did not know of these wrongful transactions prior to public disclosure of this report. In fact, an introductory paragraph of the complaint alleges: "All wrongs hereinafter complained of were discovered by BAR's new management's investigation of the intercorporate relationships and were not previously known to the new BAR management." App., at 6. At this stage in the litigation, such allegations must be accepted as true, the District Court having dismissed the suit without inquiring into the truth of any of its claims. There is accordingly no basis in the record for presuming that Amoskeag was not the victim of any deception.

But even assuming that Amoskeag received close to full value for its money, it is by no means inevitable that any recovery obtained by the railroad will inure to Amoskeag's benefit, rather than to the benefit of the corporation, its creditors, and the public it aims to serve. The Court makes much of the supposed lack of power of a court of equity to impose limitations on the use BAR might make of the recovery. *Ante*, at 11. "Traditionally," however, "equity has been characterized by a prac-

tical flexibility in shaping its remedies and by a facility for adjusting and reconciling public and private needs." *Brown v. Board of Education*, 349 U. S. 294, 300 (1955). "A court of equity may in its discretion in the exercise of the jurisdiction committed to it grant or deny relief upon performance of a condition which will safeguard the public interest." *Securities and Exchange Comm'n v. United States Realty & Improvement Co.*, 310 U. S. 434, 455 (1940).⁴ Indeed, if there be any doubt as to the power of a court of equity, BAR informed the District Court that the railroad would voluntarily enter into a stipulation to ensure that any recovery would be reinvested in the railroad, for upgrading the right-of-way and for new equipment, and that Amoskeag would voluntarily join the stipulation if requested. Brief for Respondents, at 30.

Improved equipment and rights-of-way, of course, might benefit Amoskeag indirectly by increasing to some extent the value of its equity. But such expenditures would hardly bring a dollar-for-dollar increase in the price Amoskeag would receive if it were to sell its stock. The value of a solvent railroad's stock is determined by many factors—earning capacity; historical income, excluding nonrecurring items; balance sheet strength; dividend history; and condition of plant and equipment. Under an appropriate decree, only the last of these factors would be enhanced by the railroad's recovery. It is therefore not inevitable that any recovery had by the

⁴ It is interesting to note that the majority's restrictive notions as to the power of a court of equity to direct the application of a recovery are in conflict with the majority's own suggestion for protecting the interests of innocent minority shareholders. See *ante*, at 14, n. 15. If a court of equity lacks power to direct a corporation to apply the proceeds of a recovery in any particular fashion, how can the court direct the corporation to distribute a pro-rata recovery to some, but not all, of its shareholders?

railroad would benefit its current majority shareholder and there is no basis, in any event, for deeming such a benefit a windfall.

III

But let us assume that the majority is correct in finding some windfall recovery to Amoskeag inevitable in this case. This is still but one of several factors which a court of equity should consider in determining whether the public interest would best be served by piercing the corporate veil in order to bar this action. The public interest against windfall recoveries is no doubt a significant factor which a court of equity should consider. But in this case it is clearly outweighed by other considerations, equally deserving the recognition of a court of equity, supporting the maintenance of the railroad's action against those who have defrauded it of its assets.

Equity should take into account, for example, the railroad's relationships with its creditors. BAR owes a debt of approximately \$23 million, indicating almost 90% debt ownership of the enterprise. App., at 7. If the allegations of the complaint are true, the conversion and misappropriation of corporate assets committed by petitioners placed the railroad close to the brink of bankruptcy, to the certain detriment of its creditors. The complaint alleges that net revenue in 1970 was a loss of approximately \$1.3 million. App., at 5. And one of the specific causes of action in the complaint is that Bangor Punta procured the declaration by BAR of a dividend which was unlawful under a mortgage bond indenture due to insufficient working capital. App., at 15-18.

Surely the corporation, as an entity independent of its shareholders, has an interest of its own in assuring that it can meet its responsibility to its creditors. And I do not see how it can do so unless it remains free to bring suit against those who have defrauded it of its assets. The

Court's result, I fear, only gives added incentive to abuses of the corporate form which equity has long sought to discourage—allowing a majority shareholder to take advantage of the protections of the corporate form while bleeding the corporation to the detriment of its creditors, and then permitting the majority shareholder to sell the corporation and remain free from any liability for its wrongdoing.

More importantly, equity should take into account the public interest at stake in this litigation. As the Court of Appeals indicated,

"The public's interest, unlike the private interest of stockholder or creditor, is not easily defined or quantified, yet it is real and cannot, we think, be overlooked in determining whether the corporation, suing in its own right, should be estopped by equitable defenses pertaining only to its controlling stockholder." 482 F. 2d 865, 868 (1973).

The public's interest in the financial health of railroads has long been recognized by this Court.

"[R]ailways are public corporations organized for public purposes, granted valuable franchises and privileges, among which the right to take the private property of the citizen *in invitum* is not the least, . . . many of them are donees of large tracts of public land and of gifts of money by municipal corporations, and . . . they all primarily owe duties to the public of a higher nature even than that of earning large dividends for their shareholders. The business which the railroads do is of a public nature, closely affecting almost all classes in the community . . ." *United States v. Trans-Missouri Freight Assn.*, 166 U. S. 290, 332-333 (1897).

The same public interest has been recognized in a wide variety of legislative enactments. As early as the Trans-

portation Act of 1920, "Congress undertook to develop and maintain, for the people of the United States, an adequate railway system. It recognized that preservation of the earning capacity, and conservation of the financial resources, of individual carriers is a matter of national concern; . . ." *Texas & Pac. R. Co. v. Gulf, Col. & Santa Fe R. Co.*, 270 U. S. 266, 277 (1926). Later, Congress added § 77 to Chapter VIII of the Bankruptcy Act, providing that financial reorganization of ailing railroads should be achieved for the benefit of the public, and not simply in the interests of creditors or stockholders. See *New Haven Inclusion Cases*, 399 U. S. 392, 492 (1970).

The significance of the public interest in the financial well-being of railroads should be self-evident in these times, with many of our Nation's railroads in dire financial straits and with some of the most important lines thrown into reorganization proceedings. Indeed, the prospect of large scale railroad insolvency in the northeast United States was deemed by Congress to present a national emergency, prompting enactment of the Regional Rail Reorganization Act of 1973, Pub. L. 93-236, 87 Stat. 985 (1974), in which the Federal Government, for the first time, committed tax dollars to a long-term commitment to preserve adequate railroad service for the Nation. As the Court of Appeals held, given this background, "it would be unrealistic to treat a railroad's attempt to secure the reparation of misappropriated assets as of concern only to its controlling stockholder." 482 F. 2d, at 870. "[T]he public has a real, if inchoate interest" in this action. *Id.*, at 871.

The Court gives short shrift, however, to the public interest. While recognizing that respondents' complaint is based on federal antitrust and securities statutes designed to benefit the public, and while conceding that the

statutorily designated plaintiffs are respondent corporations, the Court nevertheless holds that these plaintiffs cannot maintain this action because any recovery by Amoskeag would violate established principles of equity. *Ante*, at 13, n. 13. I cannot agree, for the public interest and the legislative purpose should always be heavily weighed by a court of equity. As this Court has frequently recognized, equity should pierce the corporate veil only when necessary to serve some paramount public interest, see *Schenley Corp. v. United States*, 326 U. S. 432, 437 (1946); *Ander-son v. Abbott*, 321 U. S. 349, 362 (1944), or "where it otherwise would present an obstacle to the due protection or enforcement of public or private rights." *New Colo-nial Ice Co. v. Helvering*, *supra*, 292 U. S., at 442. Here, however, it is the failure to recognize the railroad's own right to maintain this suit which undercuts the public interest.

The Court's result substantially impairs enforcement of the state and federal statutes upon which respondent bases many of its claims. For example, § 10 of the Clayton Act, 15 U. S. C. § 20, relied on in two substantial counts of the complaint, provides:

"No common carrier engaged in commerce shall have any dealings in securities, supplies, or other ar-ticles of commerce . . . to the amount of more than \$50,000, in the aggregate, in any one year, with another corporation . . . when the said common carrier shall have upon its board of directors or as its president . . . any person who is at the same time a director [or] manager . . . of . . . such other corpora-tion . . . unless . . . such dealings shall be with the bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding . . ."

As we have earlier had occasion to note, § 10 is not an ordinary corporate conflict of interest statute, but is part of our Nation's antitrust laws, specifically designed to protect common carriers such as railroads. See *United States v. Boston & Maine R. Co.*, 380 U. S. 157 (1965); *Minneapolis & St. Louis R. Co. v. United States*, 361 U. S. 173, 190 (1960). The purpose of § 10 "was to prohibit a corporation from abusing a carrier . . . through overreaching by, or other malfeasance of, common directors, to the financial injury of the carrier and the consequent impairment of its ability to serve the public interest." *Minneapolis & St. Louis R. Co. v. United States*, *supra*, 361 U. S., at 190.

The private causes of action brought by respondent railroad under § 10 serve to vindicate this important congressional policy. See *Klinger v. Baltimore & O. R. Co.*, 432 F. 2d 506 (CA2 1970). And by barring this suit, notwithstanding the plain allegations in the complaint that the carrier as well as the public interest it serves were injured through violations of this section committed by petitioners,⁵ the Court directly frustrates the ends of Congress. Indeed, the Court encourages the very kind of abuses § 10 was designed to prohibit. The majority shareholder of a carrier can convert and misappropriate its assets through improper intercorporate transactions, with the "consequent impairment of its ability to serve the public interest," and then wash its hands of and remain free from any legal liability for its statutory violation by selling off its interest.⁶

⁵ The complaint alleges that the special and illegal dividends which petitioners caused BAR to declare "serve to deprive plaintiff BAR of a source of cash which could and would have been utilized for necessary maintenance and equipment acquisitions, all to the injury of BAR and the public which it serves." App., at 16.

⁶ These arguments are applicable as well to the causes of action

I would find counsel instead in this Court's opinion in *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U. S. 134, 138-139 (1968). The Court took note in that case that "[w]e have often indicated the inappropriateness of invoking broad common-law barriers to relief where a private suit serves important public purposes." As we recognized,

"the purposes of the antitrust laws are best served by insuring that the private action will be an ever-present threat to deter anyone contemplating business behavior in violation of the antitrust laws. The plaintiff who reaps the reward of treble damages may be no less morally reprehensible than the defendant, but the law encourages his suit to further the overriding public policy in favor of competition. A more

stated under the Maine Public Utilities Act, 35 Maine Rev. Stat. § 104, which provides in pertinent part:

"No public utility doing business in this State shall . . . make any contract or arrangement, providing for the furnishing of . . . services . . . with any corporation . . . owning in excess of 25% of the voting capital stock of such public entity . . . unless and until such contract or arrangement shall have been found by the commission not to be adverse to the public interest and shall have received their [sic] written approval."

While different from § 10 of the Clayton Act in certain details (applying to all public utilities rather than only to carriers, and relying on the supervision of an administrative agency rather than the device of competitive bidding), the Maine statute clearly has the same underlying purpose: to protect the public interest from abuses of public utilities through intercorporate transaction with a major shareholder. While Maine law governs the causes of action under this section and the courts of Maine have, in other cases, accepted the general equitable principle that a stockholder has no standing to sue if he or his vendor participated in the wrong, see *ante*, at 9, there is no basis in Maine law for applying this equitable doctrine where the direct result is to leave remediless the very abuses § 104 was designed to prohibit.

fastidious regard for the relative moral worth of the parties would only result in seriously undermining the usefulness of the private action as a bulwark of antitrust enforcement."

These principles have even greater force here, since Amoskeag, "whatever its own lack of equity, is neither a wrongdoer nor a participant in any wrong." 482 F. 2d, at 870-871.

In the final analysis, the Court's holding does a disservice to one of the most settled of equitable doctrines, reflected in the maxim that "Equity will not suffer a wrong without a remedy." *Indep. Wireless Teleg. Co. v. Radio Corporation of America*, 269 U. S. 459, 472 (1926). Because I would follow that maxim here and permit respondent to maintain this action to seek redress for the wrongs allegedly done to it and to the public interest it serves, I respectfully dissent.

